In the

United States Circuit Court of Appeals

For the Seventh Circuit

COMMISSIONER OF INTERNAL REVENUE,

Petitioner

No. 9319 *vs.*

LEWIS F. JACOBSON,

Respondent.

LEWIS F. JACOBSON,

Petitioner

No. 9320 *vs.*

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Petitions For Review of Decision of the Tax Court of The United States.

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1 Lewis F. Jacobson,
Petitioner,
vs.
Commissioner of Internal Revenue,
Respondent.
} Docket No. 4189.

Appearances:

For Taxpayer: Sidney C. Nierman, Joseph M. Checkers.

For Commissioner: David F. Long, N. Fischer, R. C. Whitley.

DOCKET ENTRIES.

1944.

Mar. 6—Petition received and filed. Taxpayer notified. Fee Paid.

Mar. 6—Copy of petition served on General Counsel.

Apr. 17—Answer filed by General Counsel.

Apr. 17—Request for hearing in Chicago, Illinois, filed by General Counsel.

Apr. 22—Notice issued placing proceeding on Chicago, Ill. calendar. Service of answer and request made.

Dec. 21—Hearing set Mar. 5, 1945, Chicago.

1945.

Feb. 5—Notice of appearance of Sidney C. Nierman and Joseph M. Checkers as counsel filed.

Mar. 5—Hearing had before Judge Arundell on petitioner's motion to continue to next Chicago calendar granted.

Mar. 5—Order, proceeding continued to next Chicago calendar entered.

Apr. 17—Hearing set May 21, 1945, Chicago, Illinois.

May 10—Motion for continuance to the next Chicago, Illinois calendar filed by taxpayer. 5/14/45 Granted.

Aug. 20—Hearing set Oct. 1, 1945, Chicago, Illinois.

Oct. 5—Hearing had before Judge Black, on merits. Petitioner's brief due 12/1/45. Respondent's brief due 2/1/46.

1/15/46. Petitioner's reply brief due 2/1/46.

Oct. 29—Transcript of hearing Oct. 5, 1945, filed.

Nov. 26—Brief filed by taxpayer. Copy served 11/27/45.

1946.

Jan. 15—Brief filed by General Counsel. Served 1/16/46.

Feb. 1—Reply brief filed by taxpayer. 2/1/46 Copy served.

May 10—Findings of fact and opinion rendered, Judge Black. Decision will be entered under Rule 50. Copy served.

Jun. 12—Respondent's computation for entry of decision filed.

Jun. 14—Hearing set 7/17/46 on settlement.

Jun. 24—Petitioner's objection to Respondent's computation for entry of decision and alternative computation, and motion to transfer hearing on objection to Chicago, Illinois filed. 6/26/46 Denied for Chicago hearing.

Jul. 17—Hearing had before Judge Black on merits—continued. Appearance of Raymond J. Bowen as counsel filed.

Jul. 17—Order that this proceeding be continued to Washington, D. C., calendar of 8/7/46 for hearing under Rule 50 entered.

Jul. 25—Transcript of hearing 7/17/46 filed.

Aug. 1—Revised computation for entry of decision filed by General Counsel.

Aug. 7—Hearing had before Judge Black on settlement—no contest.

Aug. 7—Decision entered, Judge Black, Div. 15.

2 Oct. 31—Petition for review by U. S. Circuit Court of Appeals for the Seventh Circuit filed by General Counsel.

Oct. 31—Statement of points to be relied upon on review filed by General Counsel.

Nov. 6—Petition for review by U. S. Circuit Court of Appeals for the Seventh Circuit filed by taxpayer.

Nov. 6—Statement of points to be relied upon on review filed by taxpayer.

Nov. 7—Notice of filing petition for review and statement of points sent to J. P. Wenchel filed. Proof of service filed.

Nov. 8—Proof of service of petition for review and statement of points on taxpayer filed by General Counsel.

Dec. 2—Motion for extension to January 29, 1947 to prepare and transmit the record filed by General Counsel with consent of taxpayer.

Dec. 2—Order, enlarging the time to 1/29/47 to prepare and transmit the record entered.

1947.

Jan. 22—Certified copy of an order from the U. S. Circuit Court of Appeals for the Seventh Circuit for an extension to 3/30/47 to transmit and file the record filed.

Jan. 31—Joint designation of portions of record filed.

3 THE TAX COURT OF THE UNITED STATES.

(Caption—4189)

PETITION.

Filed Mar. 6, 1944.

The above named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency (SN: IT:MA) dated December 16, 1943, and as a basis of his proceeding alleges as follows:

1. The petitioner is an individual, and lives at 1216 Madison Park, Chicago, Illinois. The returns for the period herein involved were filed with the Collector for the First District of Illinois.

2. The notice of deficiency (a copy of which is attached and marked Exhibit A) was mailed to the petitioner on December 16, 1943.

3. The taxes in controversy are such part of the deficiency income taxes of $3,967.97 total, for the calendar years 1938, 1939, and 1940 imposed by the Commissioner as a result of the following adjustments which he illegally proposes to make:

4

	1938	1939	1940
(b) Addition to income of difference between the face value and the purchase price of bonds	$2,765.50	$1,218.50	$4,066.50
(c) Disallowance of automobile and entertainment expenses	597.97	793.34	750.55
	$3,363.47	$2,011.84	$4,817.05
Additional Tax Imposed	$ 706.33	$. 422.49	$1,903.46

4. The determination of the tax set forth in the said notice of deficiency is based upon the following errors:

(a) The Commissioner erred in failing to allow automobile and entertainment expenses in connection with his practice of law, aggregating $597.97 for 1938, $793.34 for 1939 and $750.55 for 1940.

(b) The Commissioner erred in holding that the acquisition by the petitioner of his mortgage obligations, at a price lower than the face value thereof during each of the years in question, represented taxable income to the petitioner during any of said years.

(c) The Commissioner erred in failing to hold that the holders of the bonds, being creditors of the petitioner, gratuitously and because of debtor's straitened circumstances, diminishing security and other facts, accepted from petitioner an amount less than the face value thereof.

(d) The Commissioner erred in failing to hold that the payment for said bonds at an amount less than the face value thereof did not create any taxable income to the petitioner.

5. The facts upon which the petitioner relies as the basis of this proceeding are as follows:

(a) Entertainment and Auto Expense. The Revenue Agent disallowed $597.92 for 1938, $793.34 for 1939 and $750.55 for 1940 as proper entertainment and auto expense.

In this, he acted arbitrarily and substituted his own imagination for the actual facts.

During these years, my earnings as a lawyer ran from $750 to $1,250 per week, and my reported net income was $23,788.17 for 1938, $24,385.66 for 1939 and $25,335.55 for 1940.

During these years I drew from my firm $100 cash each week which I used for individual out-of-pocket expenses downtown in connection with my practice. (The books of our firm, and my weekly cash drawings as above, were submitted to the Revenue Agent).

None of the $100 per week was used for household or family expenses. These were always paid by personal checks on my personal account. These also were submitted to the Revenue Agent.

My gross income of $35,000 to $40,000 per year, was produced from trial work and other legal matters which were attended to by me and by my office associates (from 5 to 8 lawyers) who worked with me. The disallowed sums (av-

erage about $14 per week) and was spent for lunches, dinners and incidentals in connection with office staff conferences and frequent night work, and with clients.

I held conferences, when trial work permitted, daily or evenings, to coordinate the work of the various lawyers associated with me, to supervise their activities, and generally to attend to the affairs of several hundred clients of our office, of which I am the senior partner.

When I worked nights, it was generally with an assistant and 1 or 2 stenographers. I paid all dinners, etc. These conferences and meals were in Martin's restaurant, Nottoli's, Hills, or Liggetts in our building.

This direct expense was more than $25.00 per week, and none of it was charged by me to my firm. (The testimony of the office staff, partners and associates is available to support). (The records of the office building are available as to the frequency of night attendance).

Conferences were often held with clients during lunch hours or evenings when court activities prevented office sessions. Dinners, luncheons and entertainment of clients were always paid for by me. It was useful to do so.

6 These conferences were often held at Martin's, other outside dining rooms, at home, or at the Standard Club, Covenant Club or Ravisloe Country Club. The club bills were paid by personal checks. (The charge slips of the clubs, and the testimony of the head waiters and others can be produced).

Most of our clients were located outside of the loop. It was often necessary to go there, especially in the Stock Yards and certain places on the northwest side. My car was used continuously (a) for such calls; (b) for investigation trips for witnesses and data by men in our office, and (c) for taking clients to and from business, clubs and places of entertainment. The car was brought down daily. I used the following garages on an In and Out monthly basis:

120 W. Lake Street,
183 W. Washington Street,
La Salle Hotel garage, and
W. Monroe Street.

(The garage bills are available. Often, taxicabs were used with clients.) None of these expenses were charged to my firm. Expenses for luncheons or dinners to officials in Washington or elsewhere were paid for by me and not charged to the firm or to the client.

I seldom had any money left from the $100 I drew at the end of each week for all these business expenses, and had to draw each succeeding week.

It is impractical to ask for or take receipts for moneys spent on clients or on office staff. It is very poor business and sheer nonsense to expect it.

(b) (1) Re: Bonds. The petitioner in June of 1922 purchased a half interest in the building and leasehold (running for ninety-nine years from May 1st, 1914) located at the Northwest corner of 47th Street, and Drexel Boulevard, in the City of Chicago, Illinois. In March of 1933, he bought the remaining one-half interest therein. In December, 1925, a substantial addition was made to the building. The total cost to the petitioner of the leasehold and improvements and additions is $116,580.56.

7 5. (b) (2)—On or about May 1st, 1925, petitioner borrowed the sum of $90,000 from the South Side Trust & Savings Bank, and petitioner and his wife executed 200 bonds, secured by a mortgage trust deed on the said leasehold and building, to evidence and secure the payment of said loan. The proceeds of said loan was used to pay off the existing encumbrances on the property; to pay for an addition to the building, which cost $16,250.00 and to pay the necessary broker's commission (which I believe was 10%, because it was on a leasehold) and printing of bonds and other expenses in connection with the loan.

5. (b) (3)—The bonds were payable at the rate of $2500.00 semi-annually to and including November 1st, 1931, and the balance of $57,500.00 on May 1st, 1932, with interest at 6½% per annum. All of the bonds which became due up to and including November 1st, 1931 were paid at or about their respective maturity dates.

5. (b) (4)—In June, 1931, the bank which made the loan failed. This bank was in the same block as my leasehold. My tenants and I lost our money on deposit. Rent collections shrunk. In February of 1932 petitioner applied to Bondholders Committee and to the bondholders for an extension of the time of payment of the loan becoming due on May 1st, 1932. A foreclosure proceeding was filed on the bonds and a Receiver was asked for. After much negotiation with the bondholders and the Committee, I obtained an extension of the entire unpaid balance of $57,250.00 for five years, with interest at the rate of 5% instead of 6½%. During the period of said extension, the

petitioner furnished to the bondholders, information concerning the operations of the property.

5. (b) (5)—In 1932, the financial condition of the petitioner was that of practical insolvency. Petitioner was then obligated on other mortgages and bond issues aggregating over $600,000. Also, there were claims asserted (and disputed by petitioner) by holders of mortgages given by Trustees of Land Syndicates in instances where petitioner had made contributions to purchases taken in the name of such Trustee. These exceeded $500,000 additional. Petitioner's property interests, equities and assets were less than his obligations during the entire period. This situation has continued through 1940, although petitioner has used his earnings as a lawyer to pay down some of the mortgages and bonds and interest on them. Other properties were lost by foreclosure or return to mortgage holders.

8 Petitioner's straitened circumstances were made known to the bondholders of the 47th & Drexel Leasehold and to every bondholder who desired to dispose of his bonds at less than par in 1938 to 1940 inclusive.

5 (b) (6)—In May, 1937, the bonds were again extended to May, 1942, because of petitioner's straitened circumstances as before stated, upon condition that the petitioner pay 10% of the principal of the bonds. The interest was to continue at 5%. As of January 1st, 1938, the unpaid principal had been reduced to $51,750.00.

5 (b) (7)—From 1932, until 1938, the petitioner paid interest to the holders of the bonds, and the bondholders from time to time communicated directly with petitioner for the purpose of obtaining information with respect to the condition of the property. The value of the leasehold and building during the period in question was substantially less than petitioner's cost. The property had sharply depreciated in value since its acquisition by him. Many colored people had moved into the neighborhood. Stores became vacant or paid less than half of previous rents. They are still bad and getting worse. The neighborhood had changed, and it is certain that petitioner will ultimately sustain a very large loss in connection with said property.

5 (b) (8)—During the year 1938 petitioner paid five different owners of bonds aggregating the face amount of $5,950.00, an aggregate amount of $3,148.50, which said owners in each instance, (knowing and being apprised of

all the facts concerning the leasehold, rents, neighborhood deterioration and the petitioner's-debtor's — straitened circumstances), gratuitously and without any other consideration, accepted in full payment of their respective bonds. The difference between said face value and said payment, namely $2,765.50, was held to be income to the petitioner by the Commissioner.

5 (b) (9)—During the year 1939 petitioner paid to three different owners of bonds aggregating the face amount of $2,430.00, an aggregate amount of $1,211.50, which said owners in each instance (and under the same circumstances as stated in Paragraph 5 (b) (8), gratuitously and without any other consideration, accepted in full payment of their respective bonds. It was self interest and good business judgment exercised by all prudent persons to take cash settlements, when otherwise greater losses might be incurred. I have done that very thing myself, and have advised clients to do so in similar circumstances. Most real estate bonds in Chicago were selling from 5c to 25c on the dollar in 1932 to 1940.

The difference between the said face value of these bonds, and the said payment, namely, $1,218.50 was held to be income to the petitioner by the Commissioner.

5 (b) (10)—During the year 1940, petitioner paid to eight different owners of bonds aggregating the face amount of $7,020.00, an aggregate amount of $2,953.50, which said owners in each instance, (and under the same circumstances as stated in 5 (b) (8), gratuitously and without any other consideration, accepted in full payment of their respective bonds. The difference between the said face value of these bonds, and the said payment, namely, $4,066.50 was held to be income to the petitioner by the Commissioner.

Wherefore, petitioner prays that this court may hear the proceeding and find that no income taxes are due from petitioner for the calendar years 1938, 1939 and 1940 for the items wrongfully disallowed as business expense, and for amounts added to income in connection with bond payments.

Lewis F. Jacobson,
Petitioner.

Room 2400—33 North La Salle St.,
Chicago, Illinois.

State of Illinois }
County of Cook } ss.

Lewis F. Jacobson, being first duly sworn says that he is the petitioner above-named; that he has read the foregoing Petition, and is familiar with the statements contained therein, and that the statements contained therein are true.

Lewis F. Jacobson.

Subscribed and sworn to before me this 11th day of January, A. D. 1944.

Ethel L. Stein,
(Seal) *Notary Public.*

"EXHIBIT A."

Form 1279 SN-IT-7

TREASURY DEPARTMENT.
Internal Revenue Service
Chicago 3, Illinois.

Dec. 16, 1943.

Office of
Internal Revenue Agent
In Charge
Chicago Division,
105 West Adams Street.

SN: IT:MA

Mr. Lewis F. Jacobson,
33 North LaSalle Street,
Chicago, Illinois.

Sir:

You are advised that the determination of your income tax liability for the taxable years ended December 31, 1938, 1939, and 1940, discloses a deficiency of $3,967.97 as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency or deficiencies mentioned.

Within 90 days (not counting Sunday or a legal holiday in the District of Columbia as the 90th day) from the date

of the mailing of this letter, you may file a petition with The Tax Court of the United States, at its principal address, Washington, D. C., for a redetermination of the deficiency or deficiencies.

12 Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Internal Revenue Agent in Charge, Chicago, Illinois, for the attenion of SN:IT. The signing and filing of this form will expedite the closing of your return(s) by permitting an early assessment of the deficiency or deficiencies, and will prevent the accumulation of interest, since the interest period terminates 30 days after filing the form, or on the date assessment is made, whichever is earlier.

Respectfully,

Robert E. Hannegan,
Commissioner,

By O. W. Olson,
Acting Internal Revenue Agent in Charge

Enclosures:
Statement
Form of waiver, 870
Form 1276

MA:VH

13 "EXHIBIT A."

Statement.

SN:IT

Mr. Lewis F. Jacobson,
30 North LaSalle Street,
Chicago, Illinois.

Tax Liability for the Taxable Years Ended December 31, 1938, 1939, and 1940.

* * * *

Taxable Year Ended December 31, 1938.

Adjustments to Net Income.

* * * * *

Explanation of Adjustments.

* * * * *

(b) During the year 1938 you acquired certain of your mortgage obligations at a discount. The difference between the face value and the purchase price of the bonds acquired by you during the year 1938 represents taxable income. The amount of $2,765.50 has, therefore, been added to your taxable income for the year 1938.

* * * * *

(c) It has been determined that $597.97 of the amounts claimed as automobile and entertainment expenses in the return you filed for the year 1938 represents personal
14 expense; and, therefore, is not deductible for income tax purposes.

* * * * *

Taxable Year Ended December 31, 1939.

Adjustments to Net Income.

* * * * *

Explanation of Adjustments.
Taxable Year Ended December 31, 1939.

* * * * *

(b) During the year 1939, you acquired certain of your mortgage obligations at a discount. The difference between the face value and the purchase price of the bonds acquired by you during the year 1939 represents taxable income.

The amount of $1,218.50 has, therefore, been added to your taxable income for the year 1939.

(c) It has been determined that $793.34 of the amounts claimed as automobile and entertainment expenses in the return you filed for the year 1939 represents personal expenses and is, therefore, not deductible for income tax purposes.

* * * *

15 Adjustments to Net Income.

Taxable Year Ended December 31, 1940.

* * * *

Explanation of Adjustments.

* * * *

(b) During the year 1940, you acquired certain of your mortgage obligations at a discount. The difference between the face value of the purchase price of the bonds acquired by you during the year 1940 represents taxable income. The amount of $4,066.50 has, therefore, been added to your taxable income for the year 1940.

(c) It has been determined that $750.55 of the amounts claimed as automobile and entertainment expenses in the return you filed for the year 1940 represents personal expense and is, therefore, not deductible for income tax purposes.

* * * *

16 Excerpts from Preliminary Report of Examination of Internal Revenue Agent In Charge Dated May 6, 1942, With Respect to the Year 1939.

* * * *

(c) Taxpayer uses his automobile in the partnership business in which he is a member and he is not reimbursed for the expense. He claims $\frac{2}{3}$ of his automobile expense as business expense and $\frac{1}{3}$ for personal use. Since most of this expense is incurred in traveling between home and office, it is believed that if the expense were allocated $\frac{1}{3}$ to business and $\frac{2}{3}$ to personal use the result would more correctly represent the facts. This is in accordance with Section 24 (a) (1) of the Internal Revenue Code.

Automobile expense claimed	$686.69
Automobile expense corrected	343.35
Increase in income	$343.34

Taxpayer has a fair record of most of his entertainment expenses but at the end of the year estimates $750.00 in entertainment expense that he can not substantiate. He evidently does have some expenses that can not be substantiated, and it is recommended that he be allowed $300.00 as a deduction from income. The balance should be disallowed in accordance with Section 24 (a) (1) of the Internal Revenue Code.

* * * *

17 Excerpts from Preliminary Report of Examination of Internal Revenue Agent In Charge, Dated September 17, 1942, With Respect to the Year 1940.

* * * *

(d) Taxpayer claimed automobile expenses in the amount of $1,051.66 and allocated $\frac{1}{3}$ for personal expense and $\frac{2}{3}$ for business expense. It is believed that an allocation of these expenses of $\frac{2}{3}$ personal and $\frac{1}{3}$ business will more correctly reflect the expense for business use. Therefore, $350.55 of taxpayer's deduction is disallowed under Section 24 (a) (1) of the Internal Revenue Code. Taxpayer deducted $2,264.54 in entertainment expense. Of this amount, $400.00 is disallowed as personal expense under Section 24 (a) (1) of the Internal Revenue Code.

* * * *

18 THE TAX COURT OF THE UNITED STATES.

* * (Caption—4189) * *

ANSWER.

(Filed Apr. 17, 1944.)

Comes now the Commissioner of Internal Revenue, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, and for answer to the petition filed by the above-named petitioner, admits, denies, and alleges as follows:

1 and 2. Admits the allegations contained in paragraphs 1 and 2 of the petition.

3. Admits that the taxes in controversy are income taxes for the taxable years ended December 31, 1938, 1939, and 1940. Specifically denies that the amounts in controversy

are correctly stated in paragraph 3 of the petition or that the adjustments of the Commissioner are correctly stated in subparagraphs (b) and (c), or that any adjustments made by said Commissioner were illegal.

4. (a) to (d), inclusive. Denies that the Commissioner erred as alleged in subparagraphs (a) to (d), inclusive, of paragraph 4 of the petition.

19 5 (a). Admits that the petitioner reported net income of $23,788.17 for the year of 1938, $24,385.66 for the year of 1939, and $25,335.55 for the year of 1940, and that deductions claimed for alleged automobile and entertainment expenses wer disallowed in part by the Commissioner in adjusting the petitioner's income. Denies all remaining allegations contained under subparagraph (a) "Entertainment and Auto Expense" of paragraph 5 of the petition.

(b) (1) Admits petitioner acquired in 1922 a one-half interest in a leasehold at the northwest corner of 47th Street and Drexel Boulevard in the City of Chicago, Illinois, and acquired the remaining one-half interest in 1933. Denies the remaining allegations contained in subparagraph (b) (1) of paragraph 5 of the petition.

(b) (2) Admits that on or about May 1, 1925, a mortgage trust deed was placed on the aforesaid leasehold to secure the payment of $90,000.00. Denies the remaining allegations contained in subparagraph (b) (2) of paragraph 5 of the petition.

(b) (3) Denies the allegations contained in subparagraph (b) (3) of paragraph 5 of the petition.

(b) (4) Admits that an extension of five years within which to pay the aforesaid morfgage deed of trust was obtained in 1932. Denies the remaining allegations contained in subparagraph (b) (4) of paragraph 5 of the petition.

(b) (5) Denies the allegations contained in subparagraph (b) (5) of paragraph 5 of the petition.

20 (b) (6) Admits that in May, 1937, the time for payment of the loan was extended and that as of January 1, 1938, the unpaid balance on said loan amounted to $51,750.00. Denies the remaining allegations contained in subparagraph (b) (6) of paragraph 5 of the petition.

(b) (7) Denies the allegations contained in subparagraph (b) (7) of paragraph 5 of the petition.

(b) (8) Admits that during the year of 1938 the petitioner paid $3,184.50 for bonds having a face value of

$5,950.00 and that the Commissioner determined that the difference between the face value and said payment, viz., $2,765.50, was income to said petitioner. Denies the remaining allegations contained in subparagraph (b) (8) of paragraph 5 of the petition.

(b) (9) Admits that during the year of 1939 the petitioner paid $1,211.50 for bonds having a face value of $2,430.00 and the Commissioner determined that the difference between the full value and the amount paid for said bonds, viz., $1,218.50, was income to said petitioner. Denies the remaining allegations contained in subparagraph (b) (9) of paragraph 5 of the petition.

(b) (10) Admits that during the year of 1940 the petitioner paid $2,953.50 for bonds having a face value of $7,020.00 and the Commissioner determined that the difference between the face value and the amount paid for said bonds, viz., $4,066.50, was income to petitioner. Denies the remaining allegations contained in subparagraph (b) (10) of paragraph 5 of the petition.

21 Denies, generally and specifically, each and every allegation contained in the petition not hereinbefore admitted, qualified, or denied.

Wherefore, respondent prays that the Tax Court redetermine the deficiency herein to be the amount determined by the Commissioner, viz., $3,967.97.

(Signed) J. P. Wenchel,
G. W. B.

J. P. Wenchel,
Chief Counsel, Bureau of Internal Revenue.

Of Counsel:
John D. Kiley,
Division Counsel.
Carroll Walker,
Special Attorney,
Bureau of Internal Revenue.

24 BEFORE THE TAX COURT OF THE UNITED STATES.

(Caption—4189)

Tax Court, United States Court of Appeals, 1212 Lake Shore Drive, Chicago, Illinois,
October 5, 1945,—11:00 a.m.

Met pursuant to notice.

Before:

Honorable Eugene Black, Judge.

Appearances:

Sidney C. Nierman, Esq., 33 North LaSalle Street, Chicago, Illinois, appearing on behalf of Lewis F. Jacobson, Petitioner.

David F. Long, Esq. (Honorable J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue), appearing on behalf of the Commissioner of Internal Revenue, Respondent.

25 PROCEEDINGS.

The Clerk: Docket No. 4189, Lewis F. Jacobson.

The Court: Please state your appearances.

Mr. Nierman: Sidney C. Nierman, for the petitioner.

Mr. Long: David F. Long, for the respondent.

The Court: Very well, are you ready now, Mr. Nierman?

Mr. Nierman: Yes.

The Court: You may make your opening statement of the issues involved in the case.

Opening Statement On Behalf of the Petitioner By Mr. Nierman.

Mr. Nierman: If the Court please, the taxes involved in this case are for the years 1938, 1939 and 1940. For 1938, the additional tax which was sought to be imposed by the Commissioner and to which we object is $706.23; for 1939, it was $422.49, and for 1940, $1,903.46.

I might call your Honor's attention to the fact that with respect to part of the tax objected to for the year 1938, the petitioner inadvertently paid the assessment. It appears that the agent made two examinations, and on the first examination, he reported certain additions to income, and that was paid by the petitioner. Erroneously, when we filed our petition for review, we included that as a basis for objection, but inasmuch as that has been paid by
26 the petitioner we won't offer any proof on that subject that relates to $597.97 of the 1938 income which refers to the disallowances of automobile and entertainment expenses.

The Court: Very well.

Mr. Nierman: Now, the issues in each year are substantially the same, with the exceptions that I have given you for the year 1938. The petitioner was the owner of a building at the northwest corner of 47th Street and Drexel Boulevard, Chicago, Illinois, which he acquired in 1922. It was a lease, 99-year leasehold, not a fee, with a two-story store, office and apartment building. The petitioner acquired a half interest in the beginning of June, 1922, and acquired the other half interest from his former partner. In 1923, he erected an addition to the building. The evidence will show that the total cost to the petitioner of this building, including the additions, was approximately $116,000. At the time of the purchase of the building by him there was a first mortgage of $18,000, a second mortgage of $19,500 and certain tax accumulations. In 1925 he applied to the South Side Bank and Trust Company which was located in the same block as the building—it is on the corner of 37th and Cottage Grove Avenue, which is in the same block as Drexel Avenue in the city of Chicago—for a loan of $90,000 which they granted, and the proceeds of that loan were used to pay off the existing encum-
27 brances on the property, to help repay the taxpayer for moneys he advanced to his partner in purchase of his interest, to pay for the addition that was then concurrently being constructed on the building and the broker's fee and a small surplus to the petitioner over and above the existing lien on the property and costs I have enumerated. That loan by its terms was signed by both the petitioner and his wife and was due in May of 1932. At the time the loan was made the gross income from his real estate was approximately $34,000 per annum. The net

income was $15,335.81 after payment of expenses. That income, as we will show, depreciated from 1926 down to 1938 and 1940, which are the years involved in this case. So that in the year 1938 the gross income was $16,550.00, in 1939 was $16,520.75, and in 1940, $15,578.50, and the schedule of gross income and net income correspondingly reduced itself so that the net income there from his real estate was only $1,1707.11 in 1939, and $1,719.41 in 1940.

Now, as we have stated, from 1926 to 1932, which was the period that this first loan of $90,000 was due, the property gradually depreciated in value, the neighborhood changed and due to economic conditions in Chicago and the United States the physical property had depreciated in value. When the mortgage became due, the petitioner was unable to pay that mortgage and be obtained an extension in time.

In 1932 he procured by request of the bondholders
28 committee and by personal contact with the bondholders who owned these issued bonds of $90,000 an extension of time of the unpaid principal balance, which at that time had been reduced to $57,500 on May 1, 1932, so he obtained the extension of time until May, 1937, by direct contacts with the bondholders and the committee that represented the bondholders. He went along and paid his interest in 1932 to 1937 and then again because of the condition of the property he was compelled to ask for an extension of time on his mortgage, and it was again extended until May, 1942.

Incidentally, with the extension of May, 1937, which I have described, it was necessary for the petitioner to keep in direct contact with the holders of these bonds in order to influence them to go along with the extension, because some of them were unwilling to carry the loan as long as they had. They had held the loan for some twelve years and it was necessary for the petitioner to personally contact and write to them and communicate and ask them to go along. He was doing the best he could because of the nature of the property and investment and personal resources to pay the bonds if they would wait and give him a little time, so with that 1937 extension he began to know these bondholders much better than he had known them previously. I might tell your Honor from 1932 when the bank had failed until 1937 and throughout the years
in question, the taxpayer himself paid the interest di-
29 rectly to the bondholders. The course of procedure

was for him to write checks to the bondholders directly and turn them over to the office of the bondholders committee and they in turn would return the checks in time to the bondholders, so the petitioner at all times knew who his bondholders were. Now, that brings us down to the year 1938, if the Court please.

Now, in 1938 some of the bondholders who held bonds on this issue came to the petitioner and wanted to turn in their bonds at a discount. They knew the condition of the property, apparently they knew the petitioner's resources and they were willing to sell their bonds at varying amounts less than the face amount of the bonds. I might tell you this, your Honor, in 1937 when the extension of the mortgage was granted, there was a 10 per cent flat payment made on all the bonds outstanding. So the total amount of the bond issue as reduced was $51,750. You will find from the evidence, that instead of talking about the normal $1,000 bond we talk about a $900 bond and a $450 bond because that was a flat ten per cent reduction over all the bonds, which is a little unusual.

In 1938, the petitioner bought from five different owners of bonds, bonds aggregating the face amount of $5,950 for which the petitioner paid the sum of $3,184.50. The difference between those two figures the Commissioner held to be income to the petitioner. I might say for the year 1938 there is a very small discrepancy of $43 and the petitioner's statement of it is $43.00 higher than it should be. But except for that there is no dispute as to the amount of difference between the purchase price, and the face amount of the bonds. I think the Commissioner admits these bonds were purchased at the prices alleged in the petition. Now, in 1939, the petitioner under the same circumstances as I have related paid three different owners of bonds on the face amount of $2430 an aggregate of $1,211.50, the difference there amounting to $1,218.50, which the Commissioner also held to be income. The facts with respect to the year 1940 are identical except that the amounts involved were $7,020.00 in face amount and $2,953.50 in actual amount paid for the bonds representing the difference in alleged income of $4,066.50.

Now, the circumstances as to the acquisition of these bonds varies in detail, but in substance all of these purchases were made direct from the bondholders, either by the petitioner direct from the bondholders or by the peti-

tioner's agent and the bondholders, or by the petitioner and bondholders' agent. They were direct purchases by the petitioner from the owners of bonds, for which there was no other consideration given. It was a gratuitous release by the creditor as against the debtor, Mr. Ja-
31 cobson, which by the American Dental case which your Honor remembers and under the Buckley case of this court clearly is not income.

Now, that is the first feature of the case. The second feature of the case involves some small items of entertainment expense which petitioner claimed there as a lawyer. The petitioner is a practicing lawyer, he practiced law since 1908. The firm of which he was a member has a gross income of $75,000 to $80,000 during the years in question, and the petitioner deducted the sum of $750 for general out-of-pocket expenses for which he kept no detailed record, and the Commissioner disallowed all but $300 of it and so there is $450 involved for each year with respect to that item. The other item that petitioner deducted was for automobile expense. The petitioner charged on each of his returns, two-thirds of the automobile expenses to the business and one-third to the personal use and the Commissioner held that one-third should be charged to business and two-thirds to personal use. As I have given you the figures, that is substantially the case.

The Court: Very well, Mr. Long, you may make your statement for the Commissioner.

Opening Statement On Behalf of the Respondent By Mr. Long

Mr. Long: If it please the Court, it is the contention of the respondent that the Kirby Lumber Company, 284 U. S. 1, will apply to the facts in this case. I think the evi-
32 dence will show, as Mr. Nierman has stated, that in 1922 and '23 the petitioner purchased this leasehold improved with building at 47th and Drexel Boulevard, then two years later in 1925, the petitioner borrows $90,000 from the South Side Bank & Trust Company and furnishes the Trust Company a trust deed and also gives some bonds as evidence of the $90,000 loan. These bonds, I believe, will show that they were payable to bearer. The evidence will also show I believe, that after the Trust Company had made this loan to the petitioner, the Trust

Company sold these $90,000 in bonds to the general public. The evidence will show that some time after 1933, the Trust Company resigned as trustee of this trust deed and Mr. Kilpatrick was appointed as trustee to carry on the provisions of the trustee, and he was acting as trustee during the years 1938 and 1939 and 1940, the years in this case.

The evidence will show, I think, also that there was probably a bondholders' protective committee appointed to look after the interests of the bondholders in this case, and that some of the bondholders had deposited their bonds with the bondholders' committee and that if any interest was paid on these bonds, of course, it was paid to the bondholders' committee.

The evidence will also show that some of these bonds purchased by this petitioner that are in dispute here
33 for the year 1940 were purchased by the petitioner through Anderson Plotz & Company, a brokerage firm here in Chicago. Some of the bonds probably were purchased through the bondholders' committee but not by direct negotiations with the bondholders. These bonds were floating on the open market and it is, therefore, our contention that the Kirby Lumber Company case applied to them.

Now, the petitioner claimed deduction of automobile and entertainment expenses for the years 1938, 1939 and 1940 in the respective amounts of $2,939.03 and $2,650.49 and $2,965.65. The respondent has determined that of these respective amounts, $597.97 and $793.34 and $750.55 represent personal expenses and are not deductible as entertainment and traveling expenses. We also contend, of course, that when this petitioner went out and purchased these bonds in 1938, 1939 and 1940 at less than their face value, the difference amounted to income and is includable in his income for those three years.

The Court: You may present the evidence now.

Mr. Nierman: I just want to supplement the statement I made before, in this respect: That the petitioner also will contend that during the years he purchased these bonds his financial condition was such that he would be considered insolvent in a legal contemplation. So, aside from the cases I mentioned to your Honor, strictly under
34 the petitioner's insolvency no income should be chargeable in connection with the purchase of bonds.

The Court: Very well, you may proceed with the evidence now.

Mr. Nierman: Now, Mr. Long, I could tell from your statement there must be many matters on which we will not disagree, so I hope in the interest of both the Court's and our time, if there is no dispute about a fact, you will state so, and I will do the same with you.

Mr. Long: I am willing to state all these purchases are at issue here and I want him to state how he made these purchases.

Mr. Nierman: We will state that, but let us see if we can't agree on the amount he paid for this property. There is no dispute about that, as the agency has examined that.

Mr. Long: I don't think there will be any dispute about that, no. I think I have something about that here, that's right.

Mr. Nierman: I mean, I think we will save some time, if your Honor please.

The Court: Yes.

Mr. Long: You go ahead and start stipulating about that and I will stop you.

35 Whereupon

LEWIS F. JACOBSON, called as a witness for and on behalf of the Petitioner, having been first duly sworn, was examined and testified as follows:

Mr. Nierman: Now, may it be stipulated by the parties that the petitioner in June of 1922 purchased a half interest in the building and leasehold running for ninety-nine years from May 1, 1914, located at the northwest corner of 47th Street and Drexel Boulevard, in the City of Chicago.

In March of 1933, he bought the remaining half interest therein.

Mr. Long: How about the amount he paid for it?

Mr. Nierman: I will get to the amount. In March of 1933 he bought the remaining one-half interest therein and in December of 1925 a substantial addition was made to the building. The total cost to the petitioner of the leasehold and improvement, the additions, was $116,580.56.

On or about May 1, 1925, the petitioner borrowed the sum—

Mr. Long: Wait just a minute, you haven't anything there about how much he paid when he purchased the first half and how much he paid when he purchased the second half.

The Court: What advantage is there in that if you agree about the total cost?

36 Mr. Long: That is all right, I will withdraw.

The Court: Yes.

Mr. Nierman: On or about May 1st, 1925, the petitioner borrowed the sum of $90,000 from the South Side Trust & Savings Bank and the petitioner and his wife executed two hundred bonds, secured by a mortgage trust deed on the said leasehold and building, to evidence and secure the payment of said loan. The proceeds of said loan was used to pay off the existing encumbrance on the property, to pay for an addition to the building which cost $16,250.00 and to pay the necessary brokerage commission, which was approximately 10 per cent of the loan because it was on a leasehold, and printing of bonds and other expenses in connection with the loan, and there was a small surplus over and above the items I have enumerated, which was paid to the petitioner. Now, the bonds were payable at the rate of $2500.00 semi-annually to and including November 1st, 1931, and the balance of $57,500.00 on May 1st, 1932, with interest at 6½ per cent per annum. All of the bonds which became due up to and including November 1st, 1931, were paid at or about their respective maturity dates. In June of 1931, the bank which made the loan failed.

Mr. Long: Now, we will stipulate down to that period.

Mr. Nierman: All right.

37 The Court: The facts that have been read by the counsel and agreed to by respondent's counsel are stipulated as facts in the case.

Mr. Long: Except where he says the bank failed, there, that portion will be stricken out.

The Court: Well, if you don't wish to stipulate on that part, it will be eliminated.

Mr. Nierman: Are you familiar with some of the other things in the petition with respect to the expenses, for example—

Mr. Long: We will agree to the expenses, of course, that were obtained in 1937.

Mr. Nierman: All right, I will go along with that.

Direct Examination by Mr. Nierman.

Q. Will you state your name, please?

A. Lewis F. Jacobson.

Q. What is your business or occupation?

A. I am a lawyer.

Q. And how long have you practiced law in the City of Chicago and State of Illinois?

A. Since 1908.

Q. You are a member of what law firm?

A. The present name is Jacobson, Nierman & Silbert.

38 Q. During the years 1938 and 1939, what was the firm name?

A. Jacobson, Merrick, Nierman & Silbert.

Q. Mr. Merrick died?

A. Yes.

Q. You are the taxpayer in this case?

A. Yes.

Q. Involving the petitioner?

A. Yes.

Q. Mr. Jacobson, are you familiar with the date that the South Side Trust & Savings Bank failed?

A. Yes, sir.

Q. Will you give us the date that the South Side Bank failed?

A. On June 8, 1931, it failed to open its doors. It was a subsidiary of the Foreman National Bank, and the bank was the second building from my building in the same block on 47th Street. I was representing myself and all the tenants who had their money tied up in there, the storekeepers and many of my own bondholders in this case. This bank was the one that floated the bond issue and the people were generally in the neighborhood of the bank and neighborhood of my property.

Q. Now, do you know what happened with respect to whether any representatives were appointed by any-

39 one for the bondholders who purchased bonds on your building?

A. We formed two groups, a group called the depositors

committee, and a group called the bondholders' committee. The bondholders' committee consisted of a Mr. Checkers then the contractor, and a Mr. Gerding was the secretary. Generally, I worked with Mr. Gerding. They started a foreclosure suit against me and most of my activity was with Mr. Gerding and with the bondholders direct.

Q. The bondholders' committee was a separate and distinct committee from the bank?

A. It was as fast and loose an organization as bondholders go. It was not part of the bank but they tried to shed all the tears that the bank had put out. Mine was one of them.

Q. Calling your attention to the date of May 1st, 1932, is that the date that the bond issue which you made in May of 1925 matured?

A. That is my recollection.

Q. At the time you applied to the bondholders' committee and the bondholders themselves for an extension of time of payment of this loan?

A. Yes, sir, I had a list of bondholders, I talked to Mr. Gerding about the possibility of an extension. He talked to his committee and he said he couldn't speak for the bondholders, that I would have to get in touch with them. I wrote letters and used the telephone and I drove around the neighborhood for months before I lined up the bondholders; some refused to go along and I had to go and buy them off.

Q. You did procure an extension for the bondholders?

A. I finally did.

Q. By the terms of that extension, the bonds became due in May of 1937?

A. If that is the date there, it is correct.

Q. During the interim during May of 1932 and May of 1937, what was the procedure adopted by you with respect to payment of interest to bondholders?

A. Mr. Gerding said if I would prefer to maintain contact with the bondholders, I should write out the checks to each bondholder and he would see to it that those checks were delivered to each bondholder in person. He said that was necessary for him in order to maintain his office and that was the practice in connection with other bonds. So, we wrote out the checks, I signed them and the young lady brought them over to his office and generally the bondholders that drifted into the office who didn't get the checks

or a letter in time, they were very sociable, a very sociable lot of bondholders. One man said he would never sell the bond, he was keeping it for funeral expenses, and all the other bonds he had bought in Chicago had gone com-
41 pletely sour. He had one leg, he was a frequent visitor in the office, and I am glad to see him.

Q. Mr. Jacobson, did you have kept under your supervision a list of the bondholders, the dates of payment of their interest, the numbers of their bonds, the addresses as far as you knew during this period from 1932 to 1937?

A. Yes, sir, we kept accurate complete records of all information available.

Q. You showed the very checks that were issued to the bondholders, the amounts paid and so forth?

A. Yes, sir.

Q. You, at all times, during this period were fully informed as to who your creditors were and where they were and they were informed as to your general condition, is that right?

A. I personally talked to every bondholder in Chicago about my condition through the years and as it changed I told them how hard I worked and what long hours we kept and what cases I had. Some threatened to sue and I told them to send their lawyers over and gave a complete statement of everything I had in the world. I told them they could keep the building if they liked during that period and I wouldn't ask one cent for it during that period.

Q. Now, Mr. Jacobson, in 1937, did you again procure an extension of the time of payment of these bonds?
42 A. Yes, sir, I think we paid 10 per cent. I worked that out with Mr. Gerding and two or three of the bondholders. I asked if they would go along and help me out and give me time and that I would try to work things out.

Q. That extension provided for an extension of five years, until 1942?

A. Whatever the figures are, it is correct.

Q. Was the unpaid issue of this bond issue, the principal paid as of January 1st, 1938, $51,750.00?

A. Yes, sir. At the time I wrote that and signed it I looked up every date and every amount so it is correct. I meant to state that I told my bondholders of everything I had in the world.

Mr. Long: The respondent objects because the last statement was not in response to the question.

Mr. Nierman: I will ask a question about it.

By Mr. Nierman:

Q. Now, Mr. Jacobson, do you know Beatrice Johnson, one of the bondholders of bonds secured by this bond issue on your building?

A. Yes, she and another lady came in at different times in the office.

Mr. Long: Is that Mrs. Fine?

The Witness: Yes, sir.

By Mr. Nierman:

43 Q. As a matter of fact, they were pretty close friends?

A. Well, they both came together, I don't know.

Q. These bonds you purchased in 1938, among them were there two bonds, that is, one bond numbered D-143, owned by Beatrice Johnson and Margaret Fine in the principal amount of $430.00, in the aggregate?

A. If that is stated in that record, the bond number is correct.

Mr. Nierman: Will you stipulate to these checks?

Mr. Long: You mentioned bond number what?

Mr. Nierman: 143. Did I say that?

Mr. Long: That is correct.

Mr. Nierman: It will be stipulated that the petitioner paid to Beatrice Johnson and Margaret Fine the sum of $202.50.

Mr. Long: Absolutely not.

Mr. Nierman: Oh, all right, I am sorry. I thought that was conceded.

By Mr. Nierman:

Q. Now, calling your attention to bond No. D 143, which you testified you purchased from Beatrice Johnson and Margaret Fine, will you state the circumstances under which those bonds were purchased, who paid for them and how you obtained the bonds?

A. I negotiated with those ladies at different times
44 and I told them what I could afford to pay and whenever they wanted to sell, they could come in the office. I believe in 1938, in this month I was in New York on an important matter, and I asked Mr. Nierman to take

care of it. Mr. Nierman is my partner, he is my half-brother, and he was in the office all the time.

Q. In other words, the checks of Mr. Nierman paid for these bonds, bond No. 143?

A. I told him to give his own check and I would give him the money as soon as I got back.

Q. Anyhow he was acting for you in this transaction?

A. Yes.

Q. Did you reimburse him?

A. Yes.

Q. I understand you gave him the money the same day. I show you the two checks which were issued, one to Beatrice Johnson and one to Margaret Fine, dated April 9, 1938 and marked on the reverse side in full payment of purchase price, one-half ownership of bond D-143 on the property at 47th and Drexel Boulevard and signed Beatrice Johnson, and the other check has the same markings, identical markings, only it is signed by Margaret Fine, and I ask if those were the checks delivered in payment of those bonds?

A. I did not deliver these checks but when you and I took it up, you told me about the checks and I came back, when I came back, you offered to give the checks for my record—

Mr. Nierman: Anyway, I would like to offer in evidence as Petitioner's Exhibits 1 and 2, these two checks.

Mr. Long: The respondent objects to those checks going in evidence, your Honor, unless it is shown they were delivered directly to the bondholder by the petitioner here or by his attorney in this case.

The Court: Well, what I am wondering about—and, apparently, there is no controversy between the parties as to it—is that in each of these taxable years petitioner had purchased these bonds and paid an aggregate amount for them. I don't understand the respondent's contention on that at all. He has held that the difference between the face value of the bonds and what was paid for them is income under the doctrine of the Kirby Lumber case, so I am at a loss to see why you can't agree that the amounts determined by the respondent in his deficiency notice were actually paid for these bonds and then give to us the circumstances of that purchase, everything connected with it, rather than to take up each bond by bond to show or to verify that payments were made, which, as I have understood, are not in dispute.

Mr. Long: That is right, your Honor, the only thing in dispute is how the petitioner purchased the bonds.

The Court: Yes, that I understand is at issue there. You contend that it was substantially a Kirby Lumber transaction whereas the petitioner contends it was the American Dental Company case. Now, he has proved that these two bonds were purchased and I say if you want to do it that way it will take quite some time.

Mr. Long: We are willing to stipulate, of course, that the petitioner purchased bonds during those years of a face value of so much and paid so much for them and, of course, there is the question as to how they purchased them.

Mr. Nierman: Suppose the petitioner—in other words, it will be stipulated that the failure to actually identify a particular check will not be argued as payment if there was no proof of purchase.

The Court: I don't understand that there is any controversy about the fact of purchase.

Mr. Nierman: That is right.

Mr. Long: All right, the question is how he purchased them.

Mr. Nierman: Well, I suggest perhaps the way to do it is to let me have Mr. Jacobson for a few minutes on direct examination and then, I think, we can come back to this question.

Mr. Long: Do you want to stipulate now that so many bonds were purchased in 1938, '39 and '40 of a face value of so much?

Mr. Nierman: I already made that as part of my opening statetment. There is no dispute.

The Court: I hadn't understood there was any controversy. I think the petitioner mentioned $43.00 as not being—

Mr. Nierman: I think I will prove that first and we will get rid of that.

The Court: All right.

By Mr. Nierman:

Q. Calling your attention to an item of Dr. Kemp, do you have a record of purchase from Dr. Kemp?

A. Yes, sir.

Q. Was that one of the purchases that the revenue agent included in the deficiency for the year 1938?

A. I will take your word for it.

Q. You are the witness, is it or not?

A. I understood he did, but there was no reduction in the principal at all.

Q. As a matter of fact, the Kemp bonds at the time they were purchased from Dr. Kemp were of the face amount of $900.00, were they not?

A. Yes, sir.

Q. The purchase price paid to Dr. Kemp was $957.00?

A. Yes, sir.

48 Q. As a matter of fact, the agent assumed they were $25,000 bonds and the fact of the matter is the face amount was $900.00?

Mr. Long: Will you agree to $950.00? We have $1,000.00.

The Court: There is 10 per cent off?

Mr. Long: Yes, I will agree to that.

The Court: Very well, the agreement is noted in the record.

Mr. Long: We want to agree that they purchased these bonds directly from Dr. Kemp.

Mr. Nierman: It wouldn't make any difference because there is no deficiency there.

By Mr. Nierman:

Q. Calling your attention to bonds 189-190, 191 and 192, which were owned by Margaret Fine and Beatrice Johnson, concerning which I asked you about before, this is an additional set of bonds due on June 9, 1938, purchased from Margaret Fine and Beatrice Johnson, bonds of a face amount of $3600.00?

A. Yes, sir.

Q. Did you pay $1,620.00 therefor?

A. Yes. sir.

Q. And how was the transaction handled?

A. I told them if they wanted to sell the balance 49 of their bonds and if I wasn't in the office, to see Mr. Nierman because at that time I was in court and sometimes out of the city in New York.

Q. Did Mr. Nierman, to your knowledge, acting for you, pay both Margaret Fine and Beatrice Johnson an aggregate of $1,620.00 for these bonds, directly to them?

A. I told him how much to pay them and to give a check if I wasn't there.

Q. Did Mr. Nierman pay $1,620.00 to Margaret Fine and Beatrice Johnson on June 9, 1938?

Mr. Long: The respondent objects to that because he wouldn't know.

Mr. Nierman: We will find out if he knows.

Mr. Long: I object to that, your Honor.

Mr. Nierman: There is no dispute about it, it is merely the method of doing it. There isn't any dispute.

Mr. Long: There is a way to do it.

Mr. Nierman: Do you want me to get on the stand as a lawyer and a witness, too?

The Court: There is no controversy, as I understand it, the amount was paid ultimately by the petitioner. Now, suppose he just states how it was paid. I understand there is no dispute between them only how it was paid.

By Mr. Nierman:

Q. Mr. Jacobson, do you know now whether or
50 not Mr. Nierman paid to the owners of these bonds the aggregate sum of $1,620.00?

A. Yes.

Q. Did you reimburse Mr. Nierman on or about the same date, June 9, 1938, for the exact amount?

A. Yes.

Q. Was Mr. Nierman acting as your agent and for you in the purchase of said bonds?

A. Yes.

Q. Is Mr. Nierman's office in the same office as your own, or was it on that date?

A. Yes.

Q. Did any bondholder know he was dealing with Mr. Jacobson or somebody acting for him at that time?

A. The young lady at the switchboard was instructed, if anybody came in about 47th Street and Drexel Boulevard, that if I wasn't in the office that they were to see Mr. Nierman.

Q. It was apparent if anybody could read, that the office of Mr. Nierman was the same office as Mr. Jacobson's and anybody dealing with Mr. Nierman was dealing with Mr. Jacobson?

A. Both in the same office.

Q. Now calling your attention to a purchase of bond No. M-193 on August 17, 1938 from Beatrice Johnson,
51 of a face amount of $900.00 for $405.00, was the transaction with respect to that the same as the previous transactions between you and Margaret Fine and Beatrice Johnson, namely, a payment by Mr. Nierman and

a reimbursement by you after some contact directly by you with these bondholders?

A. Yes, sir.

Q. I call your attention, Mr. Jacobson, to a bond transaction on February 15, 1939, under which you purchased from McGraw & Company $1,800.00 in bonds on that date?

A. Yes, sir.

Q. Do you remember the circumstances under which that purchase was made?

A. Yes, sir.

Q. Will you state them as near as you remember?

A. I think a man by the name of Samuels owned the bonds. About a year before that I had met him during the time when the bank failed, when we had a lot of meetings, public meetings in the neighborhood. He had asked me at different times if I could help him out and get him some money. I told him my circumstances and told him I would be glad to change places with my bag of troubles for his. In 1937 or about a year before the actual transaction took place, in 1938—

Q. This took plage in February 1939?

A. Well, '38, I noticed I had a memorandum on a
52 piece of paper that somebody called me about that bond, and said he had Samuels' bond and represented Samuels and wanted to know how much I would pay for the bond. Samuels was overloaded with bonds. I gave him a figure, I told him if I could get the money, I would take it for 40 cents, but I didn't want to at that time. I wanted him to hang on with me and weather the storm. I didn't hear anything from him, and a year later this same company said they wanted to do something for Samuels and what could I do to get rid of Samuels' bond. We dickered and finally came to an agreement at 50 cents on the dollar, I believe, and then they said they were representing Samuels and I had to go over my whole story, all over again, told them what I had in the world, what I didn't have, what I lost and what I was worth before the crash and what happened to me after that, and they finally called me up and offered me that and said they would send over the bond for the check.

Q. As a matter of fact, you issued a check on your firm account, Jacobson, Nierman & Silbert, on January 15, 1939, to McGraw & Company for $899.28?

A. I didn't have the money and I drew the money from the firm by check.

Q. Will you answer the question?

A. Yes.

Q. Is this a paid invoice you received from Mc-
53 Graw & Company?

A. Yes, sir.

Q. Now, at the time you purchased this bond, isn't it a fact that McGraw & Company—pardon me, withdraw that question. Will you look at this invoice of McGraw & Company and state whether McGraw & Company were acting as agents for you in the purchase of those bonds?

A. McGraw & Company was never my agent. I first had to send the check and then I got the bond with the payment. I never read that confirmation.

Q. As a matter of fact, McGraw & Company was your agent for the purpose of contacting Mr. Samuels?

A. No, sir, they called me up, I didn't chase McGraw & Company. There were no bonds floating around the market.

Q. In dealing with McGraw & Company, you knew you were dealing for Samuels' bond?

A. That's right. I told you that.

Q. You also knew McGraw was acting for Samuels?

A. I told you that.

Q. Now, Mr. Jacobson, did you receive from McGraw & Company a record of their purchase of that bond?

A. No, but that came in the mail this morning.

Q. I say did you this morning receive a record?

A. Well, I know nothing about their records. If they sent it in this morning, I will take their word for it.

54 Mr. Long: We have no objection to the whole thing going in, your Honor.

The Court: Very well, it will be received as Petitioner's Exhibit No. 1.

(The document referred to, was marked and received in evidence as PETITIONER'S EXHIBIT 1.)

Mr. Long: Have you copies of those?

Mr. Nierman: I haven't yet, but we will make some copies. Petitioner's Exhibit No. 1—the record will be a little simpler if I have Mr. Jacobson testify as to the contents and as to just what happened.

Mr. Long: We have no objection as to its going in just the way it is.

Mr. Nierman: All right.

Mr. Long: As far as I am concerned, you can start on the next bond.

Mr. Nierman: I will conduct my own examination. You want me to get away from this and I won't until I am finished.

The Court: Go ahead.

By Mr. Nierman:

Q. Mr. Jacobson, were you told by McGraw & Company that they were acting for H. N. Samuels, the holder of these bonds at the time you purchased them?

A. Yes, sir, they said Samuels had been in and
55 wanted to contact me.

Q. Did you know McGraw & Company were doing this as an accommodation to H. N. Samuels and they were making no charge for handling the deal?

A. So I understood.

Q. Petitioner's Exhibit No. 1 which has been introduced in evidence proved to you the statement to you at the time was true?

A. I haven't looked at it. I don't know what is in the paper that you got in your hand.

(The document was handed to Mr. Jacobson.)

The Witness: This record of McGraw & Company entitled "Purchase of Sale" indicates "February 15, 1939, H. N. Samuels" and the same date "Lewis F. Jacobson" and the figures are identical; $899.00 went in and $899.00 went out.

Q. So McGraw & Company paid exactly the same amount to H. N. Samuels as you paid to them and on the same day?

A. I so understood they were friends and helping each other out.

Q. As a matter of fact, Mr. Jacobson, in your list of bondholders which you had in your possession, you knew H. N. Samuels was the owner of the bonds in question?

A. I have had him—I have had contact with him, with
H. N. Samuels direct in the years before that on the
56 same subject and we couldn't agree.

Q. Calling your attention to that, when you bought the bonds you had no idea of buying bonds on the open market?

A. I never bought a bond on this building on the open market.

Q. All your dealings were either with the owners or their representatives?

A. Yes, all my dealings were with the representatives through me and the owner.

Q. Calling your attention to a bond, bonds Nos. C-73, 77, 78, 79 and 88, was Dolly Stoecker, the owner of those bonds, about June 16, 1939, according to your records?

A. Yes, sir.

Q. Did you on that date issue a check to her on that date in the amount of $225.00 in payment of those bonds?

A. Yes, sir.

Q. That check was charged to your personal account by the firm, was it not?

A. Yes, sir.

Q. Do you know Dolly Stoecker, or did you know Dolly Stoecker at the time on June 16, 1939?

A. Yes, sir, I had been out to her house and talked to her for a long time, the year before, when the last extension was made just before that and she went
57 along with me on the extension. I think she also called up one or two times.

Q. Was there any other consideration of any kind received by Dolly Stoecker other than this amount you paid to her?

A. No, sir.

Q. Was that true with respect to all the bonds we are testifying about, that is all you paid, as is evidenced by these checks and there was no other considerations by you or by the creditor in that transaction?

A. No other consideration except friendship and good will.

Mr. Long: Your Honor, we are going to object to all these leading questions.

The Court: Proceed, I think you have developed the matter fully.

Mr. Nierman: All right.

The Court: That is, as to the purchase of these bonds you have been enumerating.

By Mr. Nierman:

Q. Calling your attention to a bond numbered C-82 and 113, which was purchased on October 23, 1939, for which you issued a check to Anderson Plotz & Company on October 23rd, 1939.

A. Yes, sir.

58 Mr. Nierman: Did I enumerate the numbers of the bonds?

The Court: Yes.

By Mr. Nierman:

Q. Will you state the circumstances with respect to those bonds if you please?

A. Arthur Greene is a member of the firm of Anderson Plotz & Company, he was a close personal friend.

Q. Of whom?

A. Mine. I asked him if he would do something for me because I didn't have the time and I was always in the courts in different cities, and he said he would. I gave him a list of bondholders at that time and I told him there was a man named Zentner, who could get in touch with me and sell his bond. Gerding told me some of these people wanted to sell these bonds so Arthur Greene, at my request, got in touch with Ernest Zentner and bought the bonds from him, and he charged me, I see, ten dollars for the job, and I am glad he did, because my time was more occupied than his.

Q. Mr. Jacobson, I show you what purports to be a copy of the confirmation sent out by Anderson Plotz & Company to Ernest Zentner on October 31st, 1939; does that represent the transaction between Ernest Zentner and Anderson Plotz & Company?

A. It has to do with that transaction.

59 Q. Those are the bonds covered, the bonds I just described?

A. Yes, sir, Zentner knew all about me before that transaction. I told him.

Mr. Nierman: Have you any objection to this? I will make a statement for the record. Anderson Plotz & Company—

Mr. Long: I have no objection to it.

The Court: It will be received in evidence as Petitioner's Exhibit No. 2.

(The document referred to, heretofore marked as Petitioner's Exhibit No. 2, for identification, was received in evidence as PETITIONER'S EXHIBIT NO. 2.)

By Mr. Nierman:

Q. Did you on the same day that Anderson Plotz & Company purchased this bond from Ernest Zentner purchase the same from Anderson Plotz & Company?

A. I gave him the check for the amount he told me.
Q. $86.50?
A. Yes, it was a firm check.
Q. You knew at the time the bond belonged to Ernest Zentner?
A. Certainly, he got in touch with Zentner for me.
Q. His name appeared on the list of bondholders at that time?
A. First, I know he has always been a bondholder,
60 pardon me—I didn't know if you introduced in evidence those checks, and I heard the Court number them 1 and 2.
Mr. Nierman: That's right, they are not in evidence. Will you confine your functions to that of a witness and I will worry about the other.

By Mr. Nierman:

Q. Now, Mr. Jacobson, I ask you with respect to bonds purchased from Jens Hendrickson on April 4, 1940, which are bonds numbered C-74, C-75 and C-76, and will you state the circumstances of that transaction?
A. Mr. Gerding, who was the secretary of the bondholders' committee told me that some of the bondholders that drifted into his office, wanted to sell their bonds. I told him that was a question of how much money I had to buy with. He told me about Jens Hendrickson and I knew Hendrickson, he had $270.00 principal left, and I told Mr. Gerding that if he wanted to talk to Hendrickson and explain my financial condition which Gerding knew at all times, and if he wanted me to buy his bonds, I would pay him for that service. On April 4, 1940, Mr. Gerding told me that he was ready to buy Hendrickson's bonds if I back him up on it. I said, you just buy the bonds, and I will send you a check. I sent him a check for $130.00, and I said I would pay him for his trouble $7.50.
Q. As a matter of fact, the check you made out was
61 payable to Jens Hendrickson, was it not?
A. I always made the check payable to the man who was getting the money.
Q. In consummating that transaction, you gave a check to Mr. Gerding for $130.00, and also a check for $7.50 also payable to Gerding for his services in handling the transaction?
A. Gerding said he had more time than I did.
Q. The man who received the check, Mr. Jens Hendrick-

son, knew he was dealing with you and sold the bonds at that time to you?

A. Yes.

Q. The check indicated that?

A. Either it is made direct to him.

Q. I ask the same question to bond D150 purchased on May 21, 1940, from Garnet Grayson; were the circumstances with respect to that purchase identical as they were with respect to the Hendrickson purchase, except the amount?

A. The amounts were $210.00 and $7.50 to Gerding and there too, the bondholder knew he was dealing with Gerding as my representative.

Mr. Long: Respondent objects to all these leading questions, your Honor.

The Witness: Let me state I had talked to Miss Grayson and I told her to go over to Gerding, and when she
62 was ready I would send over the money for her bond.

By Mr. Nierman:

Q. Calling your attention to a transaction on May 23rd, 1940, which related to bonds M-188, 197 and 200, aggregating a face amount of $2,700.00 for which you paid $1,080.00 to Edna Mary Griffin and $27.00 to Mr. Gerding, is that right?

A. Yes.

Q. The circumstances in connection with that transaction are identical with the previous transactions which you testified to with respect to Mr. Gerding?

A. Yes.

Q. The check was made payable to Mr. Gerding?

A. Yes.

Q. And she appeared as the holder of the bond on your list?

A. I dealt with the holder.

Q. Answer the question.

A. She was on my list.

Q. Calling your attention to the transaction on June 19, 1940, which you purchased through Mr. Gerding, Mary Melody, bonds D-170, 171, 172 and 173, which aggregated $1,800.00 for a purchase price of $720.00, and for which you gave Gerding a commission of $18.00, were the circumstances of that transaction identical with the previous
63 Gerding transactions?

A. Gerding acted for me in that purchase to finish it up.

Q. The check was made payable to the holder of the bond?

A. Yes, to Mary Melody.

Mr. Long: You mean the commissions were paid in each case?

Mr. Nierman: The commission was $18.00.

The Witness: It wasn't commission I paid him for the transaction. I wasn't dealing with Gerding as a broker; I don't want that misunderstood. He was never a broker. He ran a little office.

By Mr. Nierman:

Q. Mr. Gerding was the same Mr. Gerding who you testified was secretary of the bondholders committee?

A. Yes, he was.

Q. He had an office in which he conducted business?

A. That was the only business; he never was a broker.

Q. As a matter of fact, in 1940, when these transactions took place through Mr. Gerding, Mr. Gerding's activity had diminished, had it not, as a member of the bondholders' committee?

A. It was a dying venture. He had a little office, no bigger than the Judge's desk.

64 Q. He had to have some compensation for his services?

A. I told him I didn't want him to waste his time for me, I was earning money.

Q. On each of these transactions Mr. Gerding and Mr. Zentner—isn't it a fact that the bondholders from whom the bonds were purchased knew they were selling the same to you?

Mr. Long: That calls for another conclusion of the witness.

The Witness: I would rather answer it this way, each one of these people where Gerding finished the deal, I talked to him previously, I gave him my statement of what I could afford to pay and I told him if they wanted to they could bring it over to Gerding, because they could find his office better than mine and they would find him in all of the time, so he was acting as my agent and closed the deal the same as I did.

By Mr. Nierman:

Q. Calling your attention to a transaction of July 2, 1940, in July 5, of 1940, in which you purchased bonds

numbered D-130 and 179—well, I am sorry, those are two separate transactions—in which you purchased on July 2nd bond No. D-130 through Anderson Plotz & Company. Now will you state in substance what that transaction was?

A. Who owned that bond?

65 Q. I will ask you to tell me who owned that bond?

A. I will tell you if you will let me see my record. There is, in my neighborhood, a man by the name of William Virhey, on 47th and Drexel,—I talked with him and told Gerding to pick up his bond because he was ready to sign.

Q. Is it not a fact, Mr. Jacobson, that on the same day you purchased from Anderson Plotz & Company these bonds, they purchased them from Mr. William Virhey at a price of $185.00 and you paid $200.00 to compensate them for the service charge?

A. No, you will pardon me, but I would like to state the facts. This has nothing to do with purchases by Anderson Plotz & Company. I told him to pick up the bonds and I would send the check. I sent over the check and they sent over the bonds.

Q. You knew Virhey was the owner of the bond at that time?

A. I told Greene to get in touch with Virhey.

Q. You supplied Greene with his address?

A. He didn't know him from anyone. I told him where Virhey lived and to call him up.

Q. Did he know he was acting for you?

A. Of course.

Q. Did you tell him to tell these people?

A. In every case he sent out a letter and he ex-

66 plained he was trying to help the owner by the name of Jacobson.

Q. As a matter of fact, they knew—

Mr. Long: Wait a minute, I object to these leading questions.

Mr. Nierman: I am sorry.

Mr. Long: If you want to testify, take the witness stand.

Mr. Nierman: I could do a pretty good job because I know the facts.

By Mr. Nierman:

Q. As a matter of fact, Mr. Virhey—

The Witness: I was telling the Court I would prefer to be over there.

The Court: Proceed and be careful and don't lead the witness.

By Mr. Nierman:

Q. Do you know William Virhey, or did you know William Virhey prior to this time?

A. For years he was on my bondholders' list.

Q. Prior to 1940, did you know Mr. Virhey?

A. Yes.

Q. Now, I ask you the same questions with respect to a purchase handled through Anderson Plotz & Company on July 3, 1940, which had to do with bond No. D-179; do
67 you know Mr. John F. Sullivan, of 1228 East 37th Street?

A. No, sir, he lives in New York City. I wrote him a letter and he wrote me a letter.

Q. Do you remember having some correspondence with Mr. Sullivan with respect to the general information?

A. Sullivan wanted to sell the bond and wanted to know all about interest—

Mr. Nierman: Mr. Long, you are right. These questions are leading, but I think we will save time and I don't think I can tell Mr. Jacobson what to say.

Mr. Long: I still have my right.

Mr. Nierman: Oh, you do, but it will expedite matters.

Mr. Long: I object to a letter in this case because a letter is the best evidence.

The Court: I think his answer was that he does remember some correspondence.

By Mr. Nierman:

Q. Did you furnish to Anderson Plotz, to Mr. Greene, the name of John F. Sullivan as the holder of a bond on your building?

A. Yes.

Q. Did you ask Mr. Greene to communicate with you together with other bondholders?

A. Yes.

68 Q. Did you on July 3rd, 1940—that date should be July 5th, 1940,—purchase the bond formerly held by

John F. Sullivan through Anderson Plotz & Company for the sum of $200.00?

A. Yes.

Q. And do you know that on the same day that Anderson Plotz & Company received the bond from John F. Sullivan?

A. Yes, I sent over the check when they told me they had the bond.

Mr. Long: Do you want to give the face value?

Mr. Nierman: $450.00.

By Mr. Nierman:

Q. Now, calling your attention to a bond purchased on July 11, 1940, did you purchase through Anderson Plotz & Company a bond numbered D-167, belonging to the Reverend Foley?

A. Yes, sir.

Q. What did you pay Anderson Plotz at that time?

A. I paid him $184.50. Well, I refunded to him $184.50. I sent over a check and got the bond.

Q. As a matter of fact, when you say you refunded it to him, you gave him a check for $184.50, wasn't it a fact the $4.50 was paid to Anderson Plotz as a service charge, and $180.00 was paid to the Reverend?

A. Yes, I told Greene I would pay him for his 69 trouble.

Q. You knew you were dealing with Foley in regard to the bond at that time?

A. I talked with Reverend Foley's son at different times before that and I think you will find that Edward Foley was the one that closed the deal at Anderson Plotz & Company.

Q. I ask you the same question with respect to the transaction on September 24, 1940, when you purchased bond No. D-153, which also was an Edward Foley bond.

A. That's right, it was done the same way.

Q. The transaction was substantially similar there except in that case you paid $185.00 to Anderson Plotz instead of $184.50.

A. Whatever he told me I did.

Q. On the same day you purchased the bond he received $185.00 from Anderson Plotz & Company?

A. Yes.

Q. You knew when you bought these bonds, did you,

that Mr. Foley was the seller of the bond to you and Anderson Plotz & Company was acting for you?

A. My deal was with Foley. I told him to go to Anderson Plotz. I wrote a letter, he called me up, and you see why the letter went out.

Q. Will you describe, Mr. Jacobson, all the bonds
70 you purchased during the period 1938 to 1940, both inclusive, involved in this case?

A. I think we have covered the list.

Q. Did you at any time during the year 1938 to 1940, purchase on the open market any bonds of the building at a price less than the par value thereof?

A. No, sir. I might add, there never was a market, there never were any bonds floating around.

Mr. Long: The respondent objects to the last statement, it is not responsive to the question.

The Witness: I heard you make that statement.

Mr. Nierman: Will you answer my questions and not argue with the attorney on the other side.

The Witness: All right.

By Mr. Nierman:

Q. Do you know whether or not there was a market, a so-called market, for these bonds at any time?

A. No, sir.

Q. Was anybody buying those bonds except yourself?

A. No, sir, I talked to many brokers about defaulted bonds and other bonds and I would know.

Q. There never was any listing of your bonds or a quoted price for your bonds at any time?

A. There never was a listing, nobody ever had a list at any time outside of the time Greene gave me a list
71 to pick up in '40 and '39 a small issue, and most of it was paid off.

Q. Mr. Jacobson, did you have compiled from your income tax records the gross income of this building at 47th Street and Drexel Boulevard for the years 1926 to 1940, both inclusive?

A. Yes, sir.

Q. Does this represent a true and correct transcription of your records as to the gross income and net income from that property for those years?

A. This is gross rent and expenses for those years.

Q. Are the records from which you prepared this list in court?

A. Yes, sir.

Mr. Long: May I have a copy of that?

Mr. Nierman: Certainly.

Mr. Long: If he is willing to swear this is a true and correct copy—

Mr. Nierman: I would like to have a copy of it for you. I would like to offer this as Petitioner's Exhibit No. 3, I believe it is.

The Court: I think it is.

Mr. Nierman: Petitioner's Exhibit No. 3, which is a representation of the gross income, the expenses and net income from the leasehold and real estate located at
72 the northwest corner of 47th Street and Drexel Boulevard for the years 1926 to 1940, both inclusive.

The Court: It will be received as Petitioner's Exhibit No. 3.

(The document referred to, heretofore market as Petitioner's Exhibit No. 3, for identification, was received in evidence as PETITIONER'S EXHIBIT NO. 3.)

Mr. Nierman: The purpose, of course, your Honor, is to show the change in the conditions of this property.

The Court: I understand.

By Mr. Nierman:

Q. Mr. Jacobson, have you owned other pieces of real estate during this period?

A. Yes, sir, during this period.

Q. During the period from 1920 to 1940?

A. Yes, sir.

Q. Are you familiar in a general way with real estate values during the period 1938 to 1940?

A. Yes, sir. May I give the reason I am familiar with it?

Q. To the best of your knowledge you may state.

A. I represented clients who sold real estate and contractors who built properties of various kinds, hotels, apartment buildings and store buildings. All my life I have been very active with those clients, and of people who also bought and operated theatres in different neighbor-
73 hoods, and it was my business and duty to find out all about real estate situations, and I have had an unusual amount of experience. Not all good.

Q. Most lawyers finally find that out.

A. I lost a lot of it.

Q. Now, Mr. Jacobson, do your have an opinion as to

the fair market value of this real estate from 1938 to 1940, both inclusive?

Mr. Long: I will say we will object to the answer to this question for the reason he hasn't been properly qualified as an expert witness.

The Court: Well, he is testifying as the owner of the property, and it is my understanding that the rules of evidence permit the owner of property, even though he may not be able to qualify as an expert, to give his opinion as to a fair market value of the property, and so I overrule the objection.

By Mr. Nierman:

Q. What is your opinion as to the fair market value of this leasehold and building at 47th and Drexel Boulevard for the years 1938 to 1940?

A. Twice the gross rent if you could find a buyer during those years in that neighborhood.

Q. The gross rents during those years averaged $16,000; your figure would be $32,000.

74 A. $32,000 would be about right. I would like to say I know about many transactions in that neighborhood. I have discussed them with brokers. I have had properties offered to me also in that neighborhood.

Q. The evidence has been admitted. Will you answer the question, please, if the gross income which appears on Petitioner's Exhibit 3 was approximately $16,000, would you say the approximate fair market value of this real estate too, during the years 1938 to 1940, was $32,000?

A. Yes, as to the leasehold.

Q. That is all. Mr. Jacobson, you answered the question.

The Court: Yes, you are speaking of your interest in the property.

The Witness: Yes.

Mr. Long: How about the interest in the leasehold?

By Mr. Nierman:

Q. That includes your interest in the leasehold, the real estate, the building, every interest you had in this property in 1938 to 1940, is that right, Mr. Jacobson?

A. That's right. It doesn't include the land.

Q. When you talked about the fee or leasehold, you meant you are not valuing the land?

A. No, sir, but I can give you that value.

Q. I am not asking you that, Mr. Jacobson, if you will answer my questions, we will get along fine. As far as you could determine, Mr. Jacobson.

A. May I give you the reason?

Q. No, you may not. Just answer my questions, please. If there is any reasons necessary Mr. Long will ask about them and you can tell them to him.

Mr. Jacobson, you have owned this property for approximately twenty years, is that right?

A. Yes.

Q. Are you familiar with the general neighborhood in which this property is located?

A. Yes, sir.

Q. What is the physical circumstance with respect to that particular property? I mean what type of tenancy is there, and is there any change in that tenancy?

A. If you will be kind enough not to interrupt me, I would like to answer my question in my own way.

Mr. Long: We want you to respond to the question.

The Witness: I live within a half mile south and a half mile east of the property, and I pass right along it almost every day. I have lived in the neighborhood thirty years, twenty-five to thirty years, on the south side. I have seen the neighborhood on Drexel Boulevard change from the highest class residential district, until now there are Japs and colored people around Drexel Boulevard, crawling with them, and east of it and north of my property.

I have talked with owners, the Kenwood property owners have an association, and they are up in arms. Everybody that could sold his home. We used to have the Swifts and Armours and Wilsons in that district around Woodlawn.

Mr. Nierman: Mr. Jacobson, I will have to interrupt you. Will you confine yourself to the question, what is the circumstance of that neighborhood with respect to the period of 1938 to 1940 as compared to the time you purchased the property and throughout the years, what was the circumstance as to the class of tenancy? I am not interested in the Swift or Armours. I want to know about the building in relation to the neighborhood.

The Witness: I am sorry, I would rather state the facts. When the bank failed in 1931, it remained a derelict building ever since, until the last year, when they opened a new

bank. They tried to get a warehouse for the building between the bank and me which had a theatre in it and a bowling alley, and both of those businesses died, and I had to pay money to burn some lights. Across the street in this other building is a garage and they have two or three restaurants there. They changed tenants fast.

Mr. Long: Your Honor, I object.

The Court: I think it is thus far—

Mr. Long: He should confine himself to the years
77 1938, '39 and '40. He is going back to 1932.

Mr. Nierman: The Court has ruled on the objection.

The Court: You may proceed, I have overruled the objection.

The Witness: During these years, including the years 1940 and back to 1931, I have had a great many vacancies in stores. I have had to remodel flats. I had to take a seven-room flat and cut it in half because I couldn't rent seven rooms. We supported that theatre because that was the only light spot in that block. The neighborhood is turning definitely colored. Colored people are coming into the stores, whites won't go in there, and I had to reduce the rent to the white tenants in the store from $175.00 to $40.00, because they couldn't make a go of it. The same with the flats, there have been vacancies in the flats and the rent went down from $90.00 to $35.00, and they are still at $42.00. There are other buildings right around me that have suffered the same loss.

By Mr. Nierman:

Q. Mr. Jacobson, is the tenancy in this neighborhood downward as far as values are concerned?

A. The tenancy is definitely downward. No company will make a loan in that district, no bank will make a loan, they are all afraid of it.

78 Q. As a matter of fact, a leasehold loan?

A. A leasehold loan is impossible as far as I know.

Mr. Nierman: I would like to state, your Honor, one of the purposes of this testimony. There is the Bulkley case that holds—I think that is the name of it—that the principle of the Kirby Lumber case isn't applicable where the transaction as a whole is not profitable to the taxpayer, and I want to show that the taxpayer will suffer a loss in connection with this real estate project, and that is the purpose of the testimony.

By Mr. Nierman:

Q. Now, Mr. Jacobson, did you at the request of the technical staff of the Commissioner of Internal Revenue furnish an affidavit to them as to your assets and liabilities?

A. Yes, sir.

Q. Is this a copy of the affidavit that was delivered by you?

A. Yes, sir.

Q. Did, subsequent to the furnishing of that affidavit, a revenue agent at the request of the technical staff, make an examination of the miscellaneous assets, including stocks and bonds which you owned during the years 1938, 1939 and 1940?

A. Yes, sir.

Q. Were you informed that the value of the assets
79 stated in this exhibit—

Mr. Nierman: By the way, I would like to have this referred to as Petitioner's Exhibit 4 for identification.

The Court: It will be marked for identification as Petitioner's Exhibit No. 4.

(The document referred to was marked as Petitioner's Exhibit No. 4 for identification.)

Mr. Long: May I see it?

(Document handed to Mr. Long.)

By Mr. Nierman:

Q. Were you informed that the revenue agent checked the values of the stocks and bonds and miscellaneous assets less collateral loans thereon which you stated to be at the value of approximately $50,000, that such value was approximately correct?

A. Yes, sir.

Q. When you made the statement of $50,000 as for your net value of miscellaneous assets, that was

Mr. Long: If it please the Court, the respondent is going to object to these questions. The respondent objects to any statement some revenue agent made in regard to this affidavit. I move to strike out the answer to that question. The Commissioner of Internal Revenue is not bound by
offhand statements made by a revenue agent during
80 his investigation.

The Court: I think I would have to sustain that objection. The witness himself, of course, can testify to the correctness of the statement and the values therein, but

any opinion of the revenue agent would, I think, be hearsay unless he himself were here to testify, then it might be admissible.

By Mr. Nierman:

Q. In the years 1938 to 1940, what was the approximate value of your stocks and bonds and miscellaneous assets less the collateral loans thereon?

A. About $50,000.

Q. That is as close a statement as you can make?

A. Yes, sir.

Q. Now calling your attention to the capital stock of Stony and 63rd Building, Incorporated.

A. Yes, sir.

Q. This statement says, owns the building at the northwest corner of 63rd and Stony Island, Chicago; does that represent all the capital stock of that company?

A. All but qualified shares.

Q. Was that the sole assets of Stony Island and 63rd Building in 1938?

A. Yes, sir.

Q. Is that Stony Island and 63rd Building, Incor- 81 porated, the corporation?

A. I so understood your question.

Q. Yes. How long had you owned that property, either through a corporation or yourself, prior to 1938 to 1940?

A. I became interested in 1927 or before that—two or three years before that.

Q. Did you continually from 1927 through 1940 either own said real estate yourself or own the stock of a corporation which had title to the real estate?

A. At first there was a syndicate which bought it in foreclosure of a ninety-nine year lease, and then I had to buy out my partenrs, and then I either owned it in my own name or with a corporation that owned it.

Q. So you are familiar with this property from 1925, is that the year you testified?

A. Yes. I said before 1927 the old realty company—

Q. Through 1940?

A. To the present time.

Q. And do you have an opinion as to the fair market value, cash market value of this real estate owned by Stony Island and 63rd Building, Incorporated, from 1938 to 1940?

A. Yes.

Q. And what is your opinion as to what the approximate fair market value of this real estate, or this stock, or put it this way, in the real estate from 1938 to 1940, both inclusive?

A. $250.00, no more. May I state the reasons?

Q. We will get to that in a moment.

The Court: Now, it is twelve thirty, and we will recess until two o'clock.

(Whereupon, at 12:30 p. m., a recess was taken until 2:00 p. m. of the same day.)

Afternoon Session. 2:00 p. m.

Whereupon,

LEWIS F. JACOBSON resumed his testimony as follows:

Direct Examination—Resumed.

The Court: You may now proceed.

By Mr. Nierman:

Q. Now, Mr. Jacobson, referring you again to Petitioner's Exhibit 4 for identification, an item in the assets column showing as leasehold 47th and Drexel, that is the leasehold we were talking about this morning on which the bonds were purchased?

A. Yes.

Q. That appears to be valued at $40,000; in that statement at that time when you prepared this statement, did you have before you the data with respect to the income of this property during this period?

A. No, sir.

Q. This sum of $40,000 represented your statement of what it was worth at that time?

A. I wish to be conservative and I overstated it rather than look up my figures. If I had looked up the figures, I would have put up then twice the then gross income.

Q. Other than the assets shown in this statement of the approximate values therein shown, and other than the statement in your affidavit, Petitioner's Exhibit 4, which says, "that the foregoing does not take into consideration any claims for fees for services rendered

by affiant prior to said period, did you own any other assets than those listed in this statement?

A. No.

Q. Calling your attention to those claims for fees for services, what did you refer to in that connection?

A. Well, we have many clients, sometimes they pay when we bill them. When on expenses, it is a current transaction in and out, and has to do with all the clients whose fees I was interested—

Q. That also includes cases on which you might have been working on a contingent basis where the fees had not been fixed?

A. When the job wasn't done you might not be entitled to anything and you might hope to get a substantial fee.

Q. Calling your attention to the first item of liabilities and guaranties of Stony Island and 63rd Building, Incorporated, bonds, $360,000, you stated what your liability arose out of in connection with this transaction?

A. Now, I had borrowed money to acquire interest in a ninety-nine year lease on 63rd and Stony Island
85 Avenue, and to buy some of the leasehold bonds from the real estate man who went broke in trying to remodel. I also owed money there. Ultimately, I think, in 1928 I negotiated a loan for $400,000 on that building, and the building we proposed to build adjoining it because it would give us some means of income. I had to personally guarantee that loan.

Q. In other words, in 1938 through 1940, there was an obligation of $360,000 evidenced by the bonds of the corporation which held title in that real estate, which was then the Stony Island and 63rd Building Corporation?

A. That corporation—

Q. And you personally had guaranteed in writing the payment of that debt, is that correct?

A. Yes, sir.

Q. With respect to the year 1938, did that debt become due?

A. I think it became due each year in installment amounts, and the final payment was due on October 1, 1938.

Q. On October 1, 1938, what if anything, was done about the payment of that loan?

A. I worked out an extension arrangement.

Q. Out of which you pay off the loan over a period of years?

A. I was given more time and I had to do something about people who refused to extend, but that is what
86 it was worked out. I had to turn in all the income from the property without any deduction to the trustee. They kept that income and used it to amortize the loan.

Q. You were personally liable under that extension agreement?

A. Yes, all the time.

Q. As a matter of fact, were you also required to pledge as collateral security, security for that extension or loan, the stock which you held in the hotel company?

A. Yes, sir, I had to find a tenant for the hotel, I had to put up $10,000 to start and I issued stock for that security.

Q. That was located in this building?

A. On an upper floor.

Q. The value of that stock as shown in the hotel company is listed in the assets column?

A. Everything was represented in that group.

Q. That building, of course, is the same building as shown in the assets column of $250,000, is that right?

A. Yes.

Q. What is the amount of principal indebtedness on October 1st, 1938?

A. It was more than that.

Q. Wasn't it more than $360,000?

A. Yes.

87 Q. The next liability account was the 47th and Drexel Boulevard, those were also the bonds we were talking about this morning, and that represents the figure on January 1st, 1938, is that correct?

A. Yes.

Q. There might be a slight variation in that amount by reason of purchases you made during the years 1938?

A. That is substantially correct.

Q. On January 1st, 1938?

A. Yes.

Mr. Nierman: I ask that this Petitioner's Exhibit No. 4 for identification be received in evidence.

Mr. Long: We have no objection.

The Court: It will be received in evidence as Petitioner's Exhibit No. 4.

(The document referred to, heretofore marked as Petitioner's Exhibit No. 4, for identification, was received in evidence as PETITIONER'S EXHIBIT NO. 4.)

By Mr. Nierman:

Q. Now, Mr. Jacobson, calling your attention to the item of $750.00 which you deducted in your return for the year 1939, as part of an item called expenses of entertaining clients which aggregated $1,963.80, did you state how that item $1,963.80 first was computed?

Mr. Long: The respondent, your Honor, objects
88 to his opinion about these things.

Mr. Nierman: It is not the opinion, he is going to read it.

The Court: He asked the question how it was computed.

Mr. Nierman: It is not an opinion.

Mr. Long: Oh, yes.

The Witness: I took the payments that I made by checks to the clubs, social clubs that I belonged to at the time, and they aggregated $1,618.40, I think it was that, and then I deducted a fourth of the amount for my own personal expenses there, which includes tickets you sign for your own caddy and for your own meals and that left $1,213.80, which I figured represented the amount of money I paid to those clubs by checks for entertaining our clients, the clients of the office, including judges of the court.

Mr. Long: Now, your Honor, the respondent objects to what he gave by check when checks are the best evidence. I would like to see the checks in this case.

Mr. Nierman: There is no dispute as to whether he spent that money. The portion of it which is represented by checks has been allowed by the Commissioner. The only purpose of this testimony is merely to make it, the subsequent testimony, intelligible. As a matter of fact, I think, the evidence there has been approved. We
89 did deduct, however, $750.00 for which there were no checks, and they disallowed $450.00 for that item.

Mr. Long: If that is all, there is no objection.

By Mr. Nierman:

Q. Now, you were a partner during this period in the firm of Jacobson, Nierman & Silbert?

A. Yes, sir.

Q. And was it your practice and did you during the year 1939 withdraw in cash sums of money which you used for out-of-pocket expenses?

A. Yes, sir.

Q. And have you made a summary of the amount of cash which was paid to you by said firm during the year 1939, from the books and records of said firm?

A. Yes, sir.

Q. Are the books and records representing those distributions in court?

A. Yes.

Q. What was the total amount which you withdrew in cash during the year 1939?

A. I don't know the total amount but I can explain, I can get at it in two steps. Each week or second week, I would draw from the firm an average of $100 in cash. The cashier would bring it to me and sometimes I asked for $300 to cover three or four weeks, and I got those
90 sums, those totaled $2,850.00 during the year 1939.

Now, in addition to that, I drew money from the firm in large sums, $5,000.00 or $2500.00, which I deposited in my own personal account at the Continental Bank, and when I went out of the city to engage in big parties, I would give my personal check in addition to those sums and use my own cash from other sources to entertain the people in whom our firm was interested in a business way.

Q. In other words, the only cash withdrawal you have a record of that you made in 1939 from the firm was $2,850.00, is that right?

A. In small sums of $300.00 or less; we have records of larger sums.

Q. Those were not withdrawn in cash?

A. No, sir.

Q. Now, how did you pay your personal expenses like household expenses, living expenses, or expenses for clothing and all family expenses during the year 1939?

A. Those came from moneys I had on deposit at the Continental National Bank in all of those years, and I would give my wife checks made to her or cash out of that Continental account which covered all expenses that she asked for, including clothing, charities, doctor bills and tuition for school for the children and all the way through.

Q. Did you deposit in the Continental Bank or
91 any other account any cash which you withdrew from the firm?

A. No, sir, that went as fast as I got it.

Q. All right, and during the year 1939, what was your practice with respect to working hours?

A. I hold the record for having worked for overtime

more nights and more Sundays than anybody in the building. We did a lot of work nights. I would go out seeing clients during the day and had to do the work in court at other times and at night.

Q. As a matter of fact, a large part of the business you handled necessitated your being away from the office?

A. Yes, sir.

Q. In connection with your work at night, did you work alone or did you have help?

A. No, sir, I always had an associate. Now, on Monday nights and Friday nights, we had an office conference of all the partners of those that were available to take care of the cases in the office, finding out what is doing. We never missed a Monday night during those years as I remember. I paid for the suppers, I drew no check for it and got no allowance for it. The other nights, Tuesdays, Wednesdays and Thursdays and Sundays, I worked with assistants, some were partners, some were juniors.

92 Once in awhile we had a corps of stenographers and I would give them supper money or lunch money, whichever it was, and the restaurants were right there in the building, three of them, and we took our choice from time to time, and so it was my practice at all times to spend this pocket money that I was drawing from the firm for those things.

Q. You got no credit from the firm for it?

A. No, sir.

Q. What is the fact with respect to purchase of luncheons for persons other than yourself that were associated with you in business?

A. We were so busy trying to handle our business, the only time we could discuss the work among the partners and seniors and juniors was at lunchtime, if we could all meet and whoever was there took them downstairs and we would go over the matters and discuss any issues. The oldest member, senior member, was myself and I always paid the check, and we didn't do any drinking, either.

Q. What would you say during the year 1939 were your personal expenses that you took out of this cash fund that you had from time to time, what would be the approximate amount of it?

A. You asked me that a little while ago. I said I had lunch, that's 65 cents, I can't eat much anyhow, and

supper cost maybe $1 and then a few cigars. I had
93 been a frugal liver, I hope, all my life.

Q. What would you say the total was?

A. $2.00 or $3.00 a day would cover all my personal needs that I spent money for during the day.

Q. Would you say $1000 for the year 1938 was more or less than what you spent on your personal items other than clothing that you paid for in cash?

A. $3 a day, a thousand would cover it.

Q. So that of this $2,850 that you withdrew from the firm, what is your best statement at this time of what you spent in the year 1939 for expenses directly connected, either with the entertainment of clients or with the payment of bills or lunch and dinner bills for your employees and associates during that period?

A. $1,800.

Q. You would say $1800 would be a fair statement of what it was?

A. As close as I can figure it.

Q. As a matter of fact, the amount you took for that purpose and deducted from your income was only $750, is that right?

A. Yes, I never deposited a dime in cash in the bank and I never had anything left over.

Q. Now, I have asked questions about the year 1939, I think; is there anything different in the method by which you handled this money during the year 1940?

94 A. Pardon me, I didn't finish the story about '39.

Q. All right.

A. In addition to working with my own people and partners in the office, I kept in contact with as many clients as I could. Those contacts came best during social hours. I have entertained clients and also, I say, judges of the Circuit Court of Appeals and other judges at many places in Chicago and out of Chicago.

I would like to mention a few names. We had dinners at home and, naturally, I took care of that, and you don't treat your guests as you treat yourself, you try to do a little better for them.

We have entertained clients at the Blackstone Hotel. I have a credit card there. We have entertained at the Edgewater Beach, at the Empire Room of the Palmer House, and I also have credit account there, at the Drake Hotel there are two or three nice rooms where we used to have fine suppers and entertainment and I have an account there,

not so often at the Chez Paree; the College Inn was a favorite spot as a restaurant.

Now, I have always bought football tickets and baseball tickets and have seen one game a season, although I have a book of season tickets, and that was true of all those years and years before and years since.

Q. That is true for '39 and '40?

95 A. Yes.

Now, four times a year at least we made trips out of town. Those trips were usually to French Lick. I never missed a year in thirty years there and spent ten days or two weeks in Florida at Miami, generally, and sometimes at Palm Beach and Sarasota on the West Coast, St. Petersburg, at Hot Springs practically every Christmas for the last twenty years and during odd seasons, fall and winter, at Martinsville and summers in Wisconsin.

Now, whenever I went I made it my business when I saw my clients to be with them and do the right thing. If it was possible I grabbed the check and paid it and I never kept track of those moneys. I know once there was a client of mine fronr the stock yards and it cost me $350 to show that gentleman and his wife a good time and it was well invested because it came back many times over, that is in addition to the $2850 cash I was drawing currently from the office.

Q. These items you have just described in trips out of town, were you in any way reimbursed by the firm for those expenses?

A. I never asked for money from the office and never got it.

Q. You didn't take a deduction for it any other place in your return?

A. No, sir.

96 Q. I don't know whether you answered the question, whether the situation you described for the year 1935 was substantially the same?

A. It has been the same, and 1940 has been the same, and it has been the same since, whenever I have been with clients, I spent a[illegible] out of sight was out of mind. I had a large office of lawyers and had to supply them with business.

Q. What was the gross income of the firm of which you were a member in 1939?

A. Between $75,000 and $80,000.

Q. What are the facts with respect to 1940?

A. It was about the same. Some years it was much more.

Q. As a matter of fact—

A. It was dropping off in those years and I became worried.

Q. With respect to the lawyers in the firm that produced the business, who would you say was the man in the firm that produced most of the business?

A. It was my job to produce most of the business and I think I succeeded in doing it.

Cross-Examination by Mr. Long.

Q. According to your testimony this morning, you purchased through Anderson, Plotz & Company one bond 103 in 1938 and two bonds in 1939.

Mr. Nierman: Before you go ahead, there is one question I want to ask to make the record complete.

By Mr. Nierman:

Q. These expenses of the use of your automobile that you described, did you get credit for that from the firm or from the client in any way, from the client directly or indirectly?

A. No, sir, I drove many clients in that car of mine.

Mr. Nierman: All right, go ahead.

The Court: You are through, Mr. Attorney?

Mr. Nierman: Yes. I wanted to give him one of these sheets. Will the Court pardon me just a moment?

The Court: Yes, sir.

By Mr. Long:

Q. I think you have testified that on October 23, 1939, you purchased from Anderson, Plotz & Company two bonds Nos. C-82 and C-113, having the aggregate face value of $180 for $86.50, is that right?

A. No, sir, I testified that I told Arthur Green to pick up Ernest Zentner's bond.

Q. You did?

A. And I paid him a $10 fee for the job.

Q. On those two bonds?

A. On Zentner's transaction.

Q. I am talking about those two bonds now.

A. That's right.

Q. This Green was working for Anderson, Plotz & Company?

A. Yes, sir.

Q. He claimed $10 for his services?

A. Yes, sir.

Q. Now, June 19, 1940—

A. In other words, they didn't have it in stock and for me to go over and buy something out of there, they went out and got the bond and I gave him a check.

Q. According to your statement this morning, you purchased on July 2, 1940, a bond No. D130 of the face value of $450 for $200, that was another bond which was purchased by you?

A. In the same way.

Q. From Anderson, Plotz & Company?

A. It was another transaction handled exactly the same way, through Anderson, Plotz & Company.

Q. You paid how much commission on that?

A. I think I paid him $200 and I don't remember what he charged me for his services.

Q. I mean, did you pay for his service?

A. Maybe I did, I don't know; sometimes he charged me $4.50 and sometimes $10. He may have charged 105 some amount in between those figures.

Q. He did charge you some service charge in addition to the bonds?

Mr. Nierman: That was included in the $200, that wasn't in addition.

By Mr. Long:

Q. You say you did pay him something for buying that bond for you?

A. Surely.

Q. All right. Now on July 5, 1940, you purchased bonds No. D-179, with a face value of $450 for $200 the same way from Anderson, Plotz?

A. He picked up John F. Sullivan's bond for me.

Q. You paid Green so much for buying that bond?

A. I don't know just what formal papers he had but I know I had a deal with Sullivan for $200.

Q. You paid a service charge in addition to that to Green?

A. I think so.

Mr. Nierman: I think this $200 includes that service charge.

Mr. Long: Will you let Mr. Jacobson testify?
The Witness: I don't know.

By Mr. Long:

Q. But whether it is included in that sum, you did
106 pay a service charge for purchasing that bond?

A. For acting as my agent in the transaction.

Q. You paid it to him for purchasing the bond?

A. Are you quibbling with me over words? I can't answer my question different from what you told me. I told Anderson, Plotz to pick up Sullivan's bond.

Q. You paid for his service?

The Court: He has testified to that.

By Mr. Long:

Q. Now, on July 11, 1940, you purchased bond D-167 of the face value of $450 for $184.50?

A. I bought it from Edward Foley, it was the bond of, I think, his father, Rev. William M. Foley, and Anderson, Plotz & Company handled the transaction in the same way.

Q. You purchased the bond or you had this Mr. Green of Anderson, Plotz & Company purchase the bond from Foley?

A. He was my agent in the transaction.

Q. You paid him a service charge?

A. Yes, sir, he received no pay from the other side, as far as I know.

Q. On the 24th day of September, 1940, you purchased D-153 of the face value of $450 for $185 through Anderson, Plotz & Company?

A. I think he charged me $5 for that service.

107 Q. Now, getting back to the bond from Garnet Grayson, you purchased on May 21, 1940, bond No. D-150 of the face value of $450 for $210?

A. No, I gave a check to her for $202.50 and I gave Gerding a check for $7.50, together they make $210.

Q. You didn't give the check directly to Mrs. Grayson?

A. Gerding told me Mrs. Grayson was ready to sell her bond at the price I told Gerding he could offer her. I sent him over a check for $202.50 made payable to Mrs. Grayson and a check to Gerding, made payable to Gerding, in the amount of $7.50 and he sent me the bond in due time.

Q. Mr. Gerding said the $7.50 was for his service?

Mr. Nierman: I think the testimony in connection with the deal was pretty fixed.

The Witness: Yes, sir.

The Court: He said all along he didn't purchase these bonds directly from the bondholder, that he paid a service charge to people who acted for him, as I understood it.

The Witness: I purchased the bond from Mrs. Grayson and paid Gerding for the service in acting for me. I gave him a check.

By Mr. Long:

Q. Now, all these bonds you purchased from 1938, 108 you wrote out your check and Mr. Nierman went out and paid for those bonds?

A. He didn't charge me anything for service. I gave him back the money.

Q. This transaction with Edna Mary Griffin on May 23, 1940, I think you stated you purchased bonds numbered M-188, 197 and 200 of the face value of $2700 for $1107?

A. No, you got that wrong; I made out a check to Mrs. Griffin for $1080 and gave him, Gerding, a fee for completing the transaction for me. I gave him a check for $27 for the services, his services.

Q. You didn't see Edna Mary Griffin at the time these negotiations were going on?

A. I made the negotiations, I had contacts with her for ten years. I told her to leave it with Gerding because he had more time than I had to answer all the questions the women can ask.

Q. Her husband is a doctor?

A. I never talked to her husband.

Q. You say now you didn't have any transactions with her husband in regard to these bonds?

A. I don't say I didn't; the doctor may have bedeviled me. My bondholders were free to call me. I remember getting calls from them at any hours at all. They would 109 call and say, "Is the interest going to be paid; is the bond still good?" and I would contact them all the time. As I told you this morning, they were rather friendly because they said it was the only bond that paid interest on the hose.

Q. You testified this morning that you didn't pay any commissions to Anderson, Plotz & Company. What do you call it? You paid him for the service, isn't that right?

A. I can't split hairs with you. I sent them a check for what they told me.

Q. What you say now is that those payments were commissions for buying the bond?

Mr. Nierman: I think that is a legal conclusion.

The Court: That is argumentative. He has testified to how he paid it. I understand that in this case it is the petitioner's contention that this lowering of the price of the bond in these instances was the equivalent to a readjustment of the price that brings it within the American Dental Company case. Then you also contend the alternative, that even if it isn't within the purview of that Supreme Court decision, the purchase of the bonds did not enrich the taxpayer, because he was insolvent?

Mr. Nierman: That's right.

The Court: And the respondent is contending that it doesn't come under the American Dental Company
110 case at all but rather the Kirby Lumber Company case.

Now, there is no need of arguing with the witness how he paid the commission or whatever it is he is testifying to. In the briefs I have an idea you gentlemen will enlarge on one thing and another.

Mr. Long: I would like to have these marked for identification.

By Mr. Long:

Q. Now, Mr. Jacobson, you entered into evidence this morning your Exhibit No. 2. Do you recall now from your statement what bond that covers?

A. It covers these other bonds, that is the only way I can identify it.

Q. Do you have the date?

A. That transaction took place on October 23, 1939.

Q. Now, I will hand you Respondent's Exhibit A and ask you what transaction that covers?

A. That, I think, is the transaction involving the Reverend Foley bond, the first transaction.

Q. That is dated July 10, 1940, is it not?

A. Yes, sir.

Q. And has reference to what transaction?

A. Rev. William M. Foley, it was his bond.

Q. I hand you Respondent's Exhibit B and ask you what transaction that covers?

111 A. That would be the same transaction, I mean, a similar transaction with the same Rev. Foley.

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Q. And these are the transactions through Anderson, Plotz & Company?

A. We got these papers, my bookkeeper did, some time after the whole show was over, and she put them in the file. Whether this represents the transaction, I am not going to argue.

Q. These papers cover that transaction, they are one and the same papers, in the same manner as reported on your Exhibit 2?

A. It is their way of making their records. I didn't do it.

Mr. Long: I offer in evidence Respondent's Exhibits A and B.

Mr. Nierman: The only objection I have is that it is merely cumulative to what the witness has already testified. There is no argument as to how these transactions were conducted.

The Court: The papers will be received as Respondent's Exhibits A and B, respectively.

(The documents heretofore marked RESPONDENT'S EXHIBITS A and B were received in evidence.)

By Mr. Long:

114 Q. Whenever you stayed downtown of a night time, you charged your own meals as an expense in your business?

A. I never got a cent back. I paid it out of my pocket.

Q. I mean, this money you drew from your partnership there, when you entertained your clients and your office force of a nighttime there, when you stayed there to take care of your business, you charged your meals as well as their meals as entertainment expenses to business?

A. Listen, brother, I never charged a cent to nobody. I paid the money out.

Q. You paid the money out and you claimed in your deductions from your return you included the meals you paid for.

Mr. Nierman: The evidence shows he spent at least $750 and he only charged $750, presumably he couldn't include his meals.

The Court: That is argumentative.

115 Mr. Nierman: The point is this, there is no claim that we charged our personal meals as part of that $750. We have allowed plenty room outside of $750.

The Court: I understood him on direct, in this computation he made for his deductions, he did not include any of his own meals.

Mr. Nierman: That is right.

By Mr. Long:

Q. You were living in Chicago all during 1938, '39 and '40?

A. Yes, and the $750 I charged as part of the entertainment spent. There isn't one cent in that for myself. I believe I spent three times that much, maybe four, for business purposes only, nor is any automobile expense in there.

Q. Now, for the purpose of depreciation, when you purchased this building in 1922 and 1923, I believe, according to your protest in this case, you allocated $76,580.56 to the building, that is the building in which these bonds were, and $40,000 to the leasehold; is that right?

A. I think that is right.

Mr. Nierman: That is on the basis of cost, that is a cost basis.

Mr. Long: I didn't ask him that.

Mr. Nierman: Oh!

116. The Witness: You are talking about 1922?

Mr. Long: These bonds?

The Witness: I asked you a question; are you talking about 1922?

Mr. Long: Yes.

The Witness: So am I.

By Mr. Long:

Q. These bonds that you endorsed and gave to the bank in the return for this $90,000, you borrowed, those bonds were payable to bearer, were they not?

A. I think so.

Q. Those bonds, after you turned them over

A. Pardon me, some may have a right to register their bonds, I am not sure. We have the trust deed here, I think. I am not trying to be sure about that.

Q. These bonds after you turned them over to the trust company, that is the company to which you gave the trust deed, they sold these bonds to the general public, did they not?

A. Right in that neighborhood.

Q. They sold them to the general public?

Mr. Nierman: Oh, well, we will agree they sold them to the general public.

The Court: All right.

By Mr. Long:

117 Q. You don't know who these bonds were purchased from in 1939, 1939 and 1940?

A. I do know they were from the original owners I bought them.

Q. Did you keep a list of the names of the bondholders?

A. Yes, sir, as soon as I got the names of the bondholders, I got a list together. I had to get 10 per cent to ask for the first extension and then keep in touch with them to beg for time. I know every one of them, except this one who went to Europe, who I could never get.

Q. There were several times those bonds shifted from one person to another and you bought the bonds from another party?

A. No, sir, I don't remember buying a bond from anyone except the original owner. There was a lawyer said he bought some bonds. I told him he was mistaken, it was a Mrs. Silverstein, and I finally dealt directly with her and got him out of the picture.

Q. From whom did you purchase the first half interest in this 47th and Drexel property?

A. You got it wrong. There was a lawyer, named Joseph F. Edelson and he invited me in his deal and together we bought the 99-year lease, what was left of it, and later on—

118 Mr. Nierman: Who did you buy it from, he asked you?

The Witness: A man named Herman Goodfriend.

By Mr. Long:

Q. That was 1922, that transaction?

A. That was the first time I was interested.

Q. In 1923 you purchased the second half interest in this leasehold and property?

A. Edelson sold out whatever year it was, I don't know, but I am the one that bought my partner out.

Q. In 1923 you became the owner of the entire leasehold with its improvements?

A. I don't know the year, but as soon as Mr. Edelson transferred his interest to me, I owned the whole thing.

Q. At the time, of course—

A. Things looked good.

Q. Now, this South Side Trust & Savings Bank has no connection with the original purchase of this building?

A. No, sir.

Q. It was in 1925 you borrowed the money from the South Side Trust & Savings Bank?

A. Yes.

Q. Now, this South Side Trust & Savings Bank resigned its trustee under the provisions of the trust deed about May 25, 1933, and Benjamin G. Kilpatrick was 119 appointed as successor trustee?

A. Yes.

Q. And Benjamin G. Kilpatrick was the trustee under the terms of the trust deed during 1938, 1939 and 1940?

A. There has been some dispute about that.

Mr. Nierman: I don't see the relevancy of this, who was the trustee in the bond issue.

The Court: I overrule the objection.

The Witness: I will tell you what the complications—

Mr. Long: I don't want your opinion on it.

The Witness: I wish I knew who to make—

The Court: Don't volunteer.

By Mr. Long:

Q. These bond securities have staggered dates?

A. Yes, sir.

Q. And the $90,000 mortgage was reduced to $51,750 as of May 1, 1938?

A. I believe that is right.

Q. The interest on these bonds was paid from the time it was first due on through the years 1938, 1939 and 1940?

A. There was a time when I got a reduction from 6½ per cent to 5 per cent, and whatever the rate was fixed by negotiating with the bondholders committee, I paid that interest, and all the interest has been paid right on 120 the nose.

Q. In other words, there isn't any defaulted interest on any of these bonds from the time they were first issued?

A. Except I told you it was reduced from 6½ per cent.

Q. There was no default in the payment of interest on any of the bonds?

Mr. Nierman: I think he answered the question.

The Witness: I paid whatever interest I agreed to pay to the bondholders. I was sued because somebody claimed I defaulted when I paid 6½ per cent.

By Mr. Long:

Q. Now, along about 1938, I think you tried to bring about an adjustment on the depreciation on this building on which these bonds were issued with the Bureau of Internal Revenue?

A. I would like to answer that. I never did agree with the same revenue agents on the same formula for figuring depreciation on the 99-year lease. During the years each agent had a different idea.

Q. You filed a protest, did you not, along in January, 1938, along about January, 1938, you filed a protest in which you claimed that depreciated cost of the building on this leasehold should be $41,620.69 and depreciated value of the cost of leasehold should be $22,776.08, or a total of $64,396.77?

Mr. Nierman: If the counsel is stating that as a fact, I wish to take issue. That is the amount that the Revenue Department fixed as the proper depreciation.

Mr. Long: I am talking about what he did. Shall I show him his protest?

The Witness: I don't remember the transaction, but I know I filed a protest and if you will show me anything I signed, just put it right in.

By Mr. Long:

Q. Would that be right, you claimed a protest?

A. I don't recall figures as you named them, but I don't say they are out of line. I don't know that they are the exact figures.

Q. Would that be about the figures you claim?

A. If you took them off of some protest I filed, that would be correct.

Mr. Nierman: If the Court please, I might call your Honor's attention to the fact that the depreciated cost has not been brought out.

The Court: That is what I thought, there is no issue about it. I don't recollect any issue about the cost.

Mr. Long: I was merely going to point out the value of these properties.

The Court: Well, I haven't heard it. The fact 122 is, I have understood all along the petitioner concedes the building cost a great deal more than the value there. We have no issue about the cost, I understand that is agreed to.

Mr. Nierman: That's right, your Honor.

By Mr. Long:

Q. Now, when you filed your protest in this case, you didn't recognize these bond transactions as any gift from the bondholders?

Mr. Nierman: I object to that. In the first place, there is no evidence of any protest.

Mr. Long: Just a moment; I have a right to show anything inconsistent with what his contention is now.

Mr. Nierman: If you show them, we will produce them.

Mr. Long: Yes.

By Mr. Long:

Q. I will hand you this document and I will ask you if that is the protest you filed or executed on June 8, 1942? Is that your signature?

A. Yes, sir.

Q. I will ask you on that day if you stated in connection with the mortgage against the aforesaid mentioned real estate, the taxpayer in 1938 purchased $5,950 face value mortgage bonds for $3,184.50 and purchased 123 in 1939 for $2,430, the face value of mortgage bond for $1,211.50, none of these bonds were canceled and still taxpayer holds them intact. The value of the property during 1938 and 1939 was substantially less than the unpaid balance to the mortgage. Your taxpayer contends there was no realized income on this transaction since in no way did the taxpayer improve his financial condition either before or after the purchase of the mortgage bonds and that the profit or loss on the purchase of these bonds will take place when and if the taxpayer sells or disposes of these bonds. For all practical purposes, the difference between the face value and the purchase price of the bonds represents an adjustment of the taxpayer's cost in question.

Mr. Nierman: What is wrong with that? That is a real argument.

The Court: He can ask him if he made that statement.

The Witness: It was prepared, I signed it and if it was correct then, it is correct now.

By Mr. Long:

Q. You didn't say anything in here about purchase of these bonds by direct negotiations?

Mr. Nierman: Just a moment; that is strictly argument.

The Court: That is argument. You have proof of what he had in the protest and the witness has said it wasn't.

Mr. Long: The American Dental case, your Honor, says something about a gift. If there is a gift here, the difference in the value of these bonds, there is some
124 question about the profit on these bonds. The taxpayer at his first opportunity surely would have said that these bondholders made a gift.

The Court: That, of course, is for argument; to ask him whether he didn't say so and so is superlative, it seems to me, because what he said is there. What he left unsaid might be a lot. I don't know.

Mr. Nierman: He may just have had argument enough to win his case. He didn't put in all the points.

By Mr. Long:

Q. Mr. Jacobson, your net rental income on the 47th and Drexel property during the years 1938, 1939 and 1940, was the amount you had left over after deductions, depreciation and after paying all expenses, including the interest on the outstanding bonds and taxes?

A. It is shown in my income tax return.

Mr. Nierman: That is right.

By Mr. Long:

Q. That is right, is it not, would you say that is right?

A. Yes.

The Court: All right, that is agreed to.

By Mr. Long:

Q. And the interest you paid on the outstanding bonds for the years 1938, 1939 and 1940—

125 Mr. Long: Do you want to stipulate to that?

Mr. Nierman: I am looking for the returns; go ahead, state the amount.

Mr. Long: A—was $2338.50 for 1938.

The Court: Wait until he gets his returns and save time.

The Witness: Well I know it is around $2000.

Mr. Nierman: I will stipulate to that figure as I am pretty sure it is correct.

Mr. Long: Now, for 1940, $1730.75; $1928.75 for 1939 and $1730.75 in 1940.

Mr. Nierman: That is right.

By Mr. Long:

Q. Now, when the Internal Revenue agent investigated this case, I think, you had a letter dated May 12, 1937 to the South Side Savings Bank Protection Committee in regard to the bonds, a number of these bonds, which were being held by the committee, do you have that, Mr. Jacobson?

A. I don't recall.

Mr. Nierman: What is the letter?

Mr. Long: It was dated the 5th month, the 12th day of '37.

Mr. Nierman: I don't know that we have such a letter.

The Witness: The committee never held the bonds.

126 Mr. Nierman: You may be talking about the bonds held by the receiver for the South Side Bank; is that what you are talking about? If you want to make a statement, we can admit it. Is this the letter you refer to, May 12, 1937?

Mr. Long: Yes. No, that isn't it, either. Strike out that question.

By Mr. Long:

Q. On January, in the beginning of January, 1938, most of these bonds were on deposit with bondholders committee, were they not?

A. They never were on deposit with the bondholders committee that I know it. Sometimes when an extension was necessary, the committee would send out orders to stamp them but immediately returned them. That happened in each instance except the last extension for eight years.

Q. That was subsequent to these years?

A. That was subsequent to these years.

Mr. Long: Do you have another letter there dated May 12, 1937?

Mr. Nierman: It could be; I will look. Who is it addressed to?

Mr. Long: It is addressed to the South Side Trust & Savings Protective Committee.

By Mr. Long:

Q. You were doing business with stockbrokers dur-
127 ing the years 1938, 1939 and 1940?

A. Yes, sir.

Q. One of those stockbrokers was Anderson, Plotz & Company?

A. No, they were not a brokerage house on the Exchange. The people I bought from were Shield & Company. I changed around but I never bought a share of stock through Anderson-Plotz & Company. I don't believe they are listed or authorized to trade on any—

Mr. Long: We can probably stipulate this. You have the returns there, have you, in regard to the income for the years 1938, and 1939 as gross income?

Mr. Nierman: Yes.

Mr. Long: It is stipulated by and between the parties that during the year 1938 the petitioner had income from the partnership in the amount of $35,613.41 and dividends of $1,964.91, interest, $812.50.

During the year 1939—

Mr. Nierman: Are you speaking, is that supposed to be all the income or just part or what?

Mr. Long: According to his return.

Mr. Nierman: For only those items; you are not purporting to state all his income?

Mr. Long: No, those items. During the year 1939, he had income from the following—

128 The Court: Gross income?

Mr. Long: Gross income, yes. He had gross income in the following items, income from partnership, $32,686.90, dividends, $2,094.50 and interest—

Mr. Nierman: Yes, I guess that is right.

Mr. Long: —interest, $863.38 and other income as reported on his return as $280.47 and—

Mr. Nierman: —and loss of stock of $6,213.07.

Mr. Long: And for the year 1940, he had income from the following items, income from the partnership, $26,900.11, dividends, $4,672.20; interest, $819.78 and other income of $50.63.

Mr. Nierman: Yes, and he also had—

Mr. Long: There is an additional amount included in there later on of $2887.50 from the Chicago Title & Trust Company for personal services.

Mr. Nierman: That's right, and he also has income from rents and royalties.

The Court: I am not informed that there is any issue in this case as to the amount of gross income.

Mr. Long: Your Honor, there is a question here that the petitioner has raised as to practical insolvency, and, of course, we are bringing in all this various income to show that his current expenses—

The Court: I believe those returns are in evidence.

129 Mr. Long: No, they are not. The returns contain, oh, probably, 25 to 50 receipts and I didn't want the Government to go to the expense of making photostatic copies.

Mr. Nierman: I think at the same time you should stipulate as to the interest paid out by him during the same years so that we will have a complete record.

Mr. Long: We are talking about the gross income.

Mr. Nierman: It is pretty hard to get the man's financial picture—

Mr. Long: You have a right to do that.

By Mr. Long:

Q. In 1938, and 1939 and 1940, you owned a half interest in a lot on Elston Avenue?

A. Yes, Elston Avenue. Yes, sir, I don't even know where it is.

Q. Since you are an expert on the value of real estate, would you tell us what the value was on that property during 1938, 1939 and 1940?

A. I tried to sell it for $1000 and I couldn't get a dime. Nobody ever offered me a dime, and we got it as part of a fee, Edelson and I. But I couldn't find it.

Q. What is your opinion as to the fair market value?

A. I haven't any opinion about the lot. I don't know where it is. I know nobody has ever offered to buy it from me.

130 Q. Did you have any other lots besides that one?

A. I did have.

Q. What was the cash value of your life insurance during the years 1938, 1939 and 1940?

A. I don't know, but I think I had borrowed from the bank the full cash surrender value at the time of the loan. They still have those life insurance policies.

Q. You couldn't state whether or not now your policies have any cash surrender value?

A. After they loaned me the money, I doubt it, because I asked for every cent I could get and they were calling me for margins in 1938.

Q. These bonds, or not bonds, but this liability that you stated set out in Exhibit 4 in the amount of $360,000, you say that is the liability on guarantee of Stony Island & 63rd Building, Incorporated, bonds?

A. Yes, sir.

Q. That is where you have guaranteed the payment of the bond in case the corporation doesn't pay them?

A. I think it is a direct guarantee for everything.

Q. In case the bond defaults, who is primarily liable?

A. The corporation that signed it, but they had me execute an unconditional absolute guarantee so I couldn't get out of it.

131 Q. That was when there was an extension of time in 1938, or was that prior to that time?

A. The extension was October, 1938.

Q. Prior to 1938 there wasn't any personal liability?

A. Oh, yes, from the very beginning, before they loaned me the money I had to agree to guarantee and I did, interest and principal.

Q. Now, the equity back of that bond liability, of course, was the value of the property there at Stony Island and 63rd Street?

A. Yes, sir.

Q. As you say, that property at that time was owned by a corporation?

A. By that corporation.

Q. You became secondarily liable on those bonds if the corporation didn't pay them?

A. I told you I executed a guarantee which made me equally liable absolutely. I couldn't be released under any circumstances. It is known in law, Mr. Lawyer, as an ab-

solute continuing guarantee. I don't know your name, I don't wish to be impersonal about it.

Q. But it was the first duty of the corporation to pay off those bonds?

Mr. Nierman: Oh, I object to that. I think we are getting into an argument.

132 The Court: Have you got the guarantee?

Mr. Nierman: I haven't, but I have a proposal made to the trust company signed by Mr. Jacobson when he personally asked them to extend that mortgage and the agent saw that. I think we are getting into a quibble here.

The Court: To the extent that he was liable would naturally rest upon the writing, if you have it. The writing ought to be in evidence if it is of any importance in this case.

Mr. Nierman: All right, I will find it.

Mr. Long: You look it up, and I will go ahead on something else.

By Mr. Long:

Q. The liability on these bonds, $360,000, has been reduced to $69,000?

A. I paid off some of those bonds after 1938.

Q. Part of this income that you reported in 1938, 1939 and 1940, is income from bonds you have on this property, is it not?

A. No.

Q. I will ask you if this is the income tax return of 1940 that you executed?

A. Yes, sir.

Q. Now, I refer you to one of the receipts contained therein. For the purpose of refreshing your recol-
133 lection, I will ask you what that contains there?

A. You might ask it, but I don't know.

Q. Doesn't this say Lewis Jacobson?

Mr. Nierman: Is that in Jacobson's handwriting?

The Witness: It was $27.50, April, 1940, and $287.50 to owner of bonds, Sidney Nierman, and in pencil, by someone I don't know.

Mr. Long: It is part of the substantiation you furnished in 1940.

Mr. Nierman: I beg your pardon, that is not furnished by the taxpayer. That is the Collector's own informa-

tion. It is furnished by the Chicago Title & Trust Company.

The Witness: That is the Chicago Title & Trust Company. It has the name, Chicago Title & Trust Company.

Mr. Nierman: What is the point? I mean, what is the fact you want to bring out?

Mr. Long: He is talking about being liable, about a liability on these bonds. I want to show by the income he reports on his return the $27.50 and $287.50 they received on April 1, 1940, as a result of being the owner of bonds of the Stony Island and 63rd Building, Incorporated.

Mr. Nierman: I think we will stipulate that to the extent those receipts show him to be the owner of those bonds and he was the owner of those bonds.

The Court: Very well. That stipulation will be noted in the record.

Mr. Long: We will say $27.50 and $287.50 was interest on those bonds.

The Court: Let the stipulation be noted in the record.

By Mr. Long:

Q. Now, back in 1938, in an effort to establish depreciation on this 63rd Street and Stony Island property, there, didn't you claim at that time that the building was worth $350,000 as of 1936?

A. We asked depreciation on cost, not on market value.

Q. But at that time you contended that the cost of the building—

A. The depreciated cost of a certain date. You don't get depreciation on what you think a thing is worth, you go back on your cost depreciated every year and ask for whatever allowance—

Q. Just answer me; did you or did you not contend in 1938 for the purpose of depreciation in 1938, this building was worth $350,000 itself?

A. I don't remember making any contention on the subject.

Q. This Rudolph F. Gerding you mentioned in the record on some of these bonds, he was the representative of the bondholders committee?

A. He called himself secretary of the committee. I understood he went to war.

Q. Now, these accounts receivable set out at the bottom of your Exhibit 4 in regard to claims for fees and so forth, what is your opinion as to the fair market value of those accounts receivable during the years 1938, 1939 and 1940?

A. I never put them up for sale or hock. I don't know.

Q. Could you give the Court any idea of the amount of the fees you were entitled to at that time which you hadn't collected?

A. My idea or the client's idea? Whose idea would you want?

Q. Your idea.

A. All right. We asked for a substantial fee for helping to recover for the Insull debenture holders, a lot of money from banks, and in 1937 on August 13th we worked out a settlement with those banks of all litigation in New York and Chicago.

We put in that petition, quite heavy and thick, and 136 showed we put in 13,000 hours.

Just at that time, in '38, the judge had assigned it to a master, a special master to hear the evidence. We finally got down to a dog fight between all the lawyers in the case as to who won the war. The trustee's lawyers claimed they had contributed a major share to the litigation and they should get the major fees. We proved that Jacobson almost broke his neck in Chicago and New York and had the hard pulling and should get a fee. It turned out the judge didn't approve of either side and cut everybody down to the bone.

Our office collected $61,000 for six years' work for the major people in the office. We thought we didn't get pencil money out of the case. That is the best way I can put it.

Q. This item you have noted here I suppose is a contingent fee, as shown here.

A. It didn't cover the overhead cost of the case.

Then we had the firm of White & Hawkhurst, who got a substantial part also. We had a firm in New York, Curtis, Mallet, Prevost, Colt, Mosle, who got $25,000. So I couldn't assess the total charges or claim we hoped to collect. We didn't have customers that paid us, you know, so much per diem or per hour at the end, because when you finished it, you sent a bill and if the client was
137 agreeable, you took his word for it. We didn't want to lose a client.

The Court: We will take ten minutes recess at this point.

Mr. Long: I don't have much more cross examination.

The Court: Well, I think a five minute recess. That will give the reporter a little time.

(Whereupon, a short recess was taken.)

The Court: You may proceed.

Mr. Long: If the Court please, I have a busy doctor here in the courtroom. I wonder if I could check him out now.

The Court: It is agreeable to me. You may proceed, then.

Mr. Long: Will you take the stand.

(Witness temporarily withdrawn.)

Whereupon

GEORGE D. GRIFFIN, called as a witness for and on behalf of the Respondent, having been first duly sworn, was examined and testified as follows:

Direct Examination by Mr. Long.

Q. State your name to the Court?

A. George D. Griffin.

Q. What is your business, Mr. Griffin?

138 A. I am a doctor.

Q. How long have you been in that profession?

A. Thirty-seven years, last June.

Q. Have you resided in or near Chicago, Illinois, during that time?

A. Constantly.

Q. What relation are you to Edna Mary Griffin?

A. She is my wife.

Q. Back in May, May 23, 1940, did you handle some bond sales for your wife?

A. I did.

Q. With whom did you negotiate in making those bond sales?

A. My memory, of course, is refreshed by looking at a record; may I refer to it again?

Q. You can use it for the purpose of refreshing your recollection, yes.

I want the name of the person you negotiated the sales with.

A. My file shows the balance of the equity of the bond that remained was sold through the bondholders committee to Lewis F. Jacobson at 40 flat.

Q. With whom did you negotiate in regard to the sale of those bonds?

A. I can't answer that question. It was probably 139 through some member of the bondholders committee.

Mr. Jacobson: I object and move to strike that.

The Court: If you don't remember, say so.

By Mr. Long:

Q. Were you always representing your wife with reference to those particular bonds?

A. Yes, sir.

Q. You kept them in your custody during the time?

A. They were kept in a vault, I kept books on the thing.

Q. And whenever any interest was paid on the bond, you took care of that?

A. It was deposited in the account.

Q. Are you acquainted with Lewis F. Jacobson?

A. No, sir.

Q. Do you know this gentleman sitting here?

A. No, sir.

Q. Did you ever see him before?

A. I don't think so; I may have. I live around that neighborhood of 47th and Drexel.

Q. Did you ever have any negotiations with him in 1938, 1939 and 1940 in regard to the sale of these bonds?

A. Personally?

Q. Yes.

A. No, sir, not that I recall.

140 Q. You handled all these bond transactions for your wife?

Mr. Nierman: I object to bond transactions; we are talking about only one thing that is involved here.

Mr. Long: Bond sales. I will identify them.

The Court: Identify them, please.

By Mr. Long:

Q. You handled all the bond sales on May 23, 1940, bonds identified as D. M-188, 197 and 200, with a face value of $2700?

A. 188, 200 and 197?

Q. That's right; what is the aggregate value of those bonds?

A. The face value originally was $3000, 10 per cent of which had been paid on the principal on the 5th of May, 1937.

Q. Leaving the face value?

A. $2700.

Q. $2700. And what did you receive for the sale of those bonds on that date?

A. On the 23rd of May?

Q. Yes.

A. $1080.

Q. $1080.

Mr. Long: You may cross-examine.

141 *Cross-Examination by Mr. Nierman.*

Q. Dr. Griffin, when you say you handled the transaction, who was the actual owner of these bonds?

A. My wife.

Q. At all times since it was issued?

A. That's right.

Q. Did she buy the bond through the South Side Bank & Trust Company?

A. That's right.

Q. Do you remember the check that was delivered in connection with the sale of those bonds?

A. No, sir.

Q. Would you know your wife's signature if you saw it?

A. Yes.

Q. I show you Petitioner's Exhibit 5 for identification and ask you whether the signature appearing on the reverse side of this check was the signature of your wife?

A. No.

Q. Whose signature is it?

A. It is my secretary's signature, who is also my sister.

Q. She signed your wife's name to that check?

A. She signed that check and deposited it in the bank.

142 Q. Was that made with the authority of your wife?

A. Yes, by understanding.

Q. In other words, there was no default on the part of your secretary in endorsing this check?

A. No, sir.

Q. It was done by agreement?

A. It was done by agreement.

Q. She signed that check, she did it with full authority from your wife?

A. That's right.

Q. The endorsement on that check, "Payment in full for bonds DM 188, 197 and 200," on that check was on at the time it was signed by Edna Mary Griffin?

A. She would have to answer that, because she went down and got the check and delivered the bonds.

Q. At any rate, when you sent her down, you knew she was going to get 40 cents on the principal amount of the bond in payment for those bonds, is that right?

A. Yes.

Q. That endorsement which I have read to you is evidence of that agreement, is it not?

A. Yes.

Q. You received no other consideration for the delivery of this bond to Mr. Jacobson other than the $1080?

A. No, sir, I took a loss on that, or my wife did.

143 Q. By the way, you knew at the time you had sold the bonds they were being sold to Mr. Jacobson, did you not?

A. Yes. Apparently, because my file shows that the balance of the equity was sold through the bondholders committee to Lewis F. Jacobson at 40 flat.

Q. And you knew Mr. Jacobson was the owner of the building, you knew that?

A. Yes, sir.

Q. He signed the bonds?

A. Yes, sir.

Mr. Nierman: I think that is all.

Mr. Long: I think that is all. Just a minute, Doctor—that is all.

The Court: You are excused.

(Witness excused.)

Whereupon

LEWIS F. JACOBSON, resumed the stand and testified further as follows:

Mr. Nierman: For the purpose of the record I would like to make a motion to strike the testimony of Dr. Griffin on the ground that he has not offered any evidence which is material to the issues in this case.

It doesn't appear there is any relevancy to the testimony.

The Court: Well, I deny that motion.

144 Mr. Nierman: I may take exception to it?

The Court: Yes.

Cross-Examination by Mr. Long (Continued).

Q. This property at Stony Island and 63rd Street—

Mr. Nierman: By the way, you wanted a copy of that guarantee.

Mr. Long: I don't want it; it is up to you. I would like to look at it.

Mr. Nierman: If you don't want it, you don't want it.

Mr. Long: Let me look at it.

By Mr. Long:

Q. This property at Stony Island and 63rd Street, which you say is only worth $250,000 that had a cost to you of $833,000—

A. Not quite that much.

Q. About how much?

A. I think it was something about $600,000. That is what sticks in my mind.

Q. I will ask you, when you took over this building, you didn't pay out cash in the amount of $484,000.

A. I don't remember the figures now. We paid out a lot of money.

Q. You assumed the mortgage in the amount of
145 $244,000? Do you recall when you purchased this property?

A. We bought it in an unusual way, we had to buy the fee.

Q. When did you buy the property?

A. It was before 1927.

Q. You paid out some cash, did you not, when you purchased the property?

A. Sure.

Q. Wasn't that around $484,000?

A. I don't remember the figures.

Q. Wasn't it about that amount?

A. If you will just let me tell you, I will answer the question. In my mind there sticks the figure between $550,000 and $600,000 as different moneys paid out for different interests. We bought the fee, the land, from one group and we bought the leasehold bonds from different owners and the total was recorded.

Mr. Nierman: I would like to object.

Mr. Long: Do you have any record with you in regard to that?

The Court: What is the objection?

Mr. Nierman: Asking for the relevancy.

Mr. Long: We want to show the original cost of the property and then there were some improvement on it.

Mr. Nierman: We will admit it was very much more 146 than the value in 1938, if that is what you are seeking to establish.

The Court: There is no issue that I know of in this case about the cost of the property.

Mr. Long: He also is talking about insolvency.

The Court: If you have any evidence as to the value of this property on these dates, that would be relevant but I don't think the cost would be relevant. I sustain the objection.

By Mr. Long:

Q. Now, in 1929 you made an improvement on this property in the amount of $156,000?

A. We built the addition and it cost about that, yes. I think it was in 1928.

Mr. Long: I think that is all.

Mr. Nierman: I think so.

The Court: You are excused, Mr. Jacobson. There is one more question. I wish to see whether or not I am correct about the way I remember some evidence because when we come to review this record, I don't want to have something lacking that might be supplied.

I understood the witness to testify about these expense accounts he received from the firm's cashier, amounts which aggregated $2850.

Mr. Nierman: For each year?

147 The Court: Each of the two years, 1939 and 1940?

Mr. Nierman: That is right.

The Court: Now, has it been brought out as to whether or not that was charged to him in such a way as it would be a charge against his part of the profits of the firm?

Mr. Nierman: Well, I thought I did bring that out but I will ask him that question again.

The Court: You better because if it was given to him for expenses, why that would be the firm paying the expenses.

Mr. Nierman: I think I asked that question; I had it in mind.

The Court: I don't know whether you did or not.

Redirect Examination by Mr. Nierman.

Q. Mr. Jacobson, how were these payments aggregating this amount charged off?

A. It was charged to me personally.

Q. As a withdrawal from the profits of the business?

A. Yes, and at the end of the year I was told, "You took out so much in cash and so much in checks, maybe there is nothing due you." Maybe there wasn't, I don't know.

Q. Now, Mr. Jacobson, I am sure I asked that question in another way, I think I said in no way were you credited for that sum by the firm?

148 The Court: I think you did but you can ask him now if you want to.

By Mr. Nierman:

Q. So that those sums of $2850 each were sums that you in no way received credit for by the firm as a firm expense?

A. No, sir, I never received any credit from the firm for a dime that I paid out in the manner I explained for entertaining customers or officers.

Q. I am talking about the $2850 that was charged to your account?

A. I am talking about the $2850 and additional sums I paid.

The Court: Very well.

By Mr. Nierman:

Q. Mr. Jacobson, I show you what purports to be a forebearance agreement dated September 15, 1939, and ask you whether that is another agreement which evidences the extension of the bond issue on the Stony Island and 63rd Building as of that date?

A. Yes, sir.

Q. Now, I show you what purports to be a guarantee on the last page of this extension agreement and ask you whether that is your signature on the guarantee?

A. That is my signature.

149 Q. Was the duplicate original of this document which I show you actually delivered to the representatives of the bondholders on that building?

A. Yes.

Mr. Nierman: All right, now I think for purposes of convenience that it might be better for me to read this guarantee.

Mr. Long: I would like to have this go in.

Mr. Nierman: Do you want this to go in?

Mr. Long: I don't want this to go in, but I think I will object to reading part of it. I want an opportunity to read the whole thing.

Mr. Nierman: I will offer this forebearance agreement, but I will ask your Honor to have leave to withdraw it and substitute photostatic copies.

Mr. Long: Will you furnish me a copy?

The Court: Is this Exhibit 6? That is agreeable.

Mr. Nierman: Exhibit No. 5 was not introduced in evidence, but it was referred.

The Court: Well, you don't necessarily have to introduce something that has been put in for identification unless you want to.

Mr. Nierman: I don't propose to do it.

Mr. Long: I would like to see it then.

Mr. Nierman: That is the check I referred to with 150 Dr. Griffin. That is Exhibit 6.

The Court: It will be received as Petitioner's Exhibit No. 6.

(The document referred to was marked and received in evidence as PETITIONER'S EXHIBIT NO. 6.)

Mr. Nierman: I think I will offer this Exhibit 5 in evidence.

The Court: It will be received as Petitioner's Exhibit No. 5.

(The document referred to was marked and received in evidence as PETITIONER'S EXHIBIT NO. 5.)

The Witness: Mr. Nierman, the guarantee I signed in 1928 was substantially similar to the one in 1938.

Mr. Long: The respondent moves to strike that out for the reason it is not responsive to any question.

The Court: Very well. It will be stricken.

Mr. Nierman: What is the guarantee you signed on the bond?

The Court: You better ask him a question.

By Mr. Nierman:

Q. Was the guarantee which you executed on or about the date of the issue of the bond, namely, October 1, 1928, substantially the same as the guarantee which appears as part of Petitioner's Exhibit No. 6?

A. Yes, sir, I signed a separate document which was substantially similar.

151 Q. And that you refer to in Petitioner's Exhibit 6?

A. Yes, sir.

The Court: That is all.

Mr. Long: That is all. I would like to ask the Court to withdraw Respondent's Exhibits A and B for the purpose of substituting photostatic copies.

The Court: Very well, that permission is granted.

(Witness excused.)

Mr. Long: I would like to call Mr. Thoman.

Whereupon:

ALBERT R. THOMAN, called as a witness for and on behalf of the Respondent, having been first duly sworn, was examined and testified as follows:

Direct Examination by Mr. Long.

Q. State your name for the Court.

A. Albert R. Thoman.

Q. What is your business, Mr. Thoman?

A. I am with the government as an appraiser in the evaluation section in the Chicago division.

Q. And does that include the valuation of real estate?

A. Entirely in my job.

Q. And how long have you been in that business?

A. Sixteen years.

Q. About how much value have you appraised dur-
152 ing that time?

A. I would say easily $250,000,000 worth of real estate.

Q. How much of that value was in the city of Chicago and vicinity?

A. I would say 98 per cent of it was around Chicago.

Q. Have you testified before in the Tax Court as an expert in the fair market value of real estate?

A. I have.

Q. Are you familiar with the property and land and building at Stony Island and Harper Avenue owned by Mr. Jacobson?

A. I am.

Q. That is the same property that Mr. Jacobson testified was only worth $250,000?

Mr. Nierman: I object to that.

Mr. Long: I am trying to identify the property.

The Court: Identify the property. You needn't quote Mr. Jacobson.

By Mr. Long:

Q. That is the same property Mr. Jacobson testified to on the witness stand?

A. I think so.

Q. What does this property consist of?

A. There is a frontage of 300 feet on 63rd Street and it runs 90 feet north on Stony Island and 90 feet north
153 on Harper, on the front of the tracks facing on 63rd Street is the five-story basement store and hotel building which was formerly an apartment building in the days when it was originally erected and the rear is a four-story building without basement and it is connected with the front building by a one-story section running from the back of the lobby to 63rd Street. Now, the building comprises apartments and stores and hotel rooms and the two buildings as such are operated above the store floor or first floor as hotels and apartments. The rear building, according to the record I have, was erected in 1929, the front building was erected in 1888, and it appears to be an apartment building entirely and was converted to, I would say, the hotel and single apartment units some time

after that date, and the building is of brick and mill and steel frame construction.

Q. What was the reasonable fair market value of this land and building during the years 1938, 1939 and 1940?

A. In my opinion, not less than $410,000.

Mr. Long: You may cross-examine.

Cross-Examination by Mr. Nierman.

Q. Mr. Thoman, prior to the time you became an appraiser for the government, what was your business or occupation?

A. I was a revenue agent.

Q. Have you ever been a real estate man?

154 A. I was associated with some real estate subdivisions, not as a broker.

Q. You never were a broker on improved real estate?

A. No.

Q. Your experience with valuing real estate since you became an appraiser of the government was confined to matters which involved determining the fair market value for tax purposes?

A. Yes, sir, for gain and loss on sale at any time.

Q. In other words, the fair market value on assets received on liquidation?

A. Breakup of land and building and cost.

Q. In connection with depreciation, in fact, the major portion of your work was in the breakdown of buildings and land for depreciation purposes?

A. Evaluation.

Q. For other purposes in connection with tax work?

A. To which the taxpayer was entitled.

Q. All right, when did you see this building that is involved?

A. Oh, I have seen this building since 1913 very often.

Q. Do you live in that neighborhood?

A. No, I live north. I was down the other day and made an inspection from the top floor down to the bottom.

Q. What factors did you use in determining wheth-
155 er it was worth $410,000?

A. I tell you what I did. The front building is of mill construction and comprises 1,015,000 cubic feet. Now, in 1938, I figured that building to cost about 44 cents new.

Q. You are talking about the front building?

A. That is 300 by 50. The rear building isn't quite the same construction. It is cheaper and I figured that building in 1938 had around about 416 or 420,000 cubic feet and I figured that at 40 cents, and I arrived at the present value. Now, for the old building, built in 1888, we used the life of 52 years and we figured that building in 1938 had a sound value of 20 years to go.

Q. On the basis of a 52-year life?

A. Yes. The other building was built in 1929 and we figured that building had 40 years to go from 1938. Now, we found the reproductive sound value, and on the basis of data on hand got the income from that property for the years 1930 to 1937, which was an average of $51,000, and expenses based on the data were a little over $18,000. There was an income there of a little over $32,000. Taking into account the share of that income applying to the front building and rear and applying our factors in the way of present value for the total rent to be expected until the building was exhausted economically, I arrived at a figure, and I took the mean of that figure and repro-
156 ductive sound value and I arrived at $165,000 for the front building and $120,000 for the rear building and $125,000 for the land, which makes $410,000.

Q. How much did you say the rear building cost to erect?

A. In 1938 I figured that building cost about 40 cents.

Q. In other words, you didn't take the cost of the building as constructed in 1929 and take a normal depreciation on that?

A. No, I figured what the building costs in 1938 amounted to in comparison to the other years.

Q. Let's go back to the front building for a moment, you say you put an estimated life of 52 years on that?

A. That 52 years was established.

Q. Was established?

A. Yes, prior.

Q. In other words, it was 52 years prior to that time the building had been erected?

A. No, 52 years total life. That was in connection with this prior case of Mr. Jacobson in the office. They agreed to 52 so I stuck to the 52.

Q. You don't follow my question: you said you took the estimated life of that building at 52 years, is that right?

A. The total life from the time of erection considering the improvement.

157 Q. Which improvement?

A. There were improvements made on that building some time between 1888 and 1927. They revamped the structure.

Q. How old was that building in 1928?

A. The big end of it was about 55 per cent old construction, and the new portion was around about 45 per cent.

Q. I don't understand that answer. It is not intelligible.

A. I am taking the old and the new and separating them. In 1888—

Q. The building was how old in 1938?

A. Fifty years old.

Q. You said the stated life of that building was 52 years?

A. Yes, based on the reconstruction that took place on that building interveningly.

Q. How much was spent on reconstruction to your knowledge?

A. There must have been a lot of money, but there is no data on that and nobody has it.

Q. You couldn't really appraise the reproduction value of that building without knowing the improvement made interveningly?

A. I don't think it has anything to do with the matter. I can look at a building and tell you how much a build-
158 ing of that sort could be built for.

Q. You stated on direct examination, you stated that the total life of this building was 52 years?

A. I based that on the fact that Mr. Jacobson and Mr. Checker came into the office and insisted on the 52 year life percentage. I would have put a longer life on that building, but a 52-year life was agreed upon and we used that to continue.

Q. Do you know what is the front of that building, how does that street look, describe it to the Court.

A. I will tell you this, there is an elevated there, a street carline on the street.

Q. There is an elevated which runs almost parallel with the hotel rooms?

A. Yes, that goes up there, I would say, maybe to the third story.

Q. In other words, anyone who resided on the first three floors would have the elevated right in front of them?

A. That was the same when it was built and that hasn't hurt that property.

Q. That is right though?

A. Yes.

Q. Did you buy or sell any property or ascertain any sale price for this building in 1938 or any other time?

A. No.

Q. In other words, you made no effort to determine
159 what the fair market value price of this real estate was in 1938?

A. There was no sale.

Q. Do you know what comparative real estate did sell for in 1938?

A. In my opinion it would be that a willing buyer and seller could have agreed very handily on $410,000.

Q. But you didn't make any investigation about that?

A. I made my own appraisal.

Q. By your basis of arriving at that, there would be no way of knowing what a willing buyer would have paid in relation to your basic value?

A. You didn't have a sale in 1938.

The Court: Don't argue. Find out, and I think you have found out upon what he based his statement. You may interrogate him if you haven't developed that. Let's not get into any argument.

Mr. Nierman: I am sorry. I agree with you.

By Mr. Nierman:

Q. Would the fact that the first mortgage bonds that were outstanding against that building were selling at less than par have any effect on your valuation of the building?

A. Well, I tell you personally from my experience and looking up the bond issues as to the way they were selling and considering the way the average bondholder got
160 it in the neck, I would say the bond sales wouldn't have a lot of bearing on my idea of value.

Q. Wouldn't?

A. Would not.

Q. No matter if the bonds were sold between persons who were willing buyers and sellers of bonds who traded in bonds at regular times?

A. If you started out with a preliminary, creating a lot of sympathy, some people might have sympathy for it and sell you cheap.

Q. Do you know anybody that would have paid $410,000 for that property?

A. That is a pretty difficult question.

Q. Answer it.

A. I would say no, I don't.

Mr. Nierman: That is all.

The Court: The witness is excused.

(Witness excused.)

Mr. Long: Mr. Talbot, will you take the stand.

Whereupon:

R. C. TALBOT called as a witness for and on behalf of the Respondent, having been first duly sworn, was examined and testified as follows:

161 *Direct Examination by Mr. Long.*

Q. State your name to the Court.

A. R. C. Talbot.

Q. And what is your business, Mr. Talbot?

A. I am a valuation engineer with the Chicago Division of Internal Revenue Bureau.

Q. Does that consist of the valuation of real estate and the estimated useful life of its improvement?

A. It does.

Q. How long have you been that business, that type of business?

A. About five years.

Q. How long have you been in that business in Chicago?

A. That full length of time.

Q. About how many pieces of real estate have you valued in Chicago and the vicinity within the last five years?

A. About 50, in excess of 50.

Q. Are you familiar with the leasehold and improvement owned by Mr. Jacobson at 47th and Drexel Boulevard, Chicago, Illinois?

A. I am.

Q. What does that consist of?

A. That consists of a leasehold of which was dated—may I refer to my notes?

162 The Court: Yes.

The Witness: Which was dated in about 1915 for a term of 99 years. The dimensions being 200 feet on 47th Street and 80 feet on Drexel, that was improved by a two-story brick store office and apartment building.

By Mr. Long:

Q. About how many apartments in the building?

A. About ten.

Q. Are there some store buildings on the ground floor?

A. It is entirely store buildings on the ground floor, about fourteen.

Q. About how many store buildings on the ground floor?

A. My notes indicate fourteen.

Q. Were there any business offices on the second floor?

A. There were—my notes do not indicate how many.

Q. What side of the street is it on?

A. That is on the northwest corner of the intersection of Drexel and 47th Street.

Q. What was the fair reasonable market value of that leasehold and the improvement ~~thereon~~ during the years 1938, 1939 and 1940?

A. Not less than $80,000, between $80,000 and $100,000.

Mr. Long: You may cross-examine.

163 *Cross-Examination by Mr. Nierman.*

Q. Mr. Talbot, what was your business or occupation prior to becoming an appraiser for the tax division?

A. I was a construction engineer principally, operating in industrial equipment.

Q. Not in real estate?

A. It was not in real estate.

Q. Have you ever been in the real estate business?

A. I have not.

Q. And since working for the government, you haven't been in the real estate business except in connection with your work as an appraiser for the government?

A. That is all.

Q. And is your function the same as Mr. Thoman's with respect to your opportunity for appraising real estate in connection with tax questions?

A. That is correct.

Q. How did you arrive at this value that you state of $80,000?

A. I inspected the property in about 1942, which is the date of the report which I have made. I also obtained the opinion of others, such as county assessor and Olcott and by using appropriate and acceptable means of capitalizing income and the combination of these and with certain judgment which I am presumed to have as a graduate engineer, I have arrived at these values.

Q. You just state how you arrived at it, in detail.

A. The value by Olcott is presumed to be a consensus of opinion of real estate dealers, which is published each year.

Q. What value did you take for the real estate?

A. I used one of the comparable values, $225.00.

Q. $225 for what unit?

A. Per front foot, and $130 for the valuation on the side, which in this case had the shorter dimension, the 80 foot depth.

Q. In other words, you added both the frontage on 47th Street and the frontage on Drexel?

A. No, I took a factor to use for a depth factor, I compared that with the assessible value. For the year 1938 it comprises the figures which I used.

Q. And what was your figure you used for your land value in 1938?

A. $39,600.

Q. In other words, you put a value on the land of $39,600?

A. That is right.

Q. All right, proceed. What is your other value?

A. The value for the building was based on a combination of reproductive depreciated value, value and comparison with an economic return as evidenced by 1938 income somewhat. I will strike that "somewhat." I show in this report that the income was $8,422.45, and less the income attributable to the value of the land at $39,600, I used six per cent, leaving a net attributable to the building of $6,046.45, which is speculative income over the duration of the useful life. That gave a total of

$163,254.15. That is a total income over the 27 years stated remaining. The life stated to be 27 was accepted as being agreed in a prior report covering about the year 1936, not compiled by me.

Then, discounting this total of $163,254.15 by cost premise, using a factor of ten and four, the speculative factor being ten, the sinking fund factor being four, I arrived at a present value of the building of $48,582.31, the sum total of these being $88,182.31.

Q. And how did you give effect to the fact that it was a leasehold instead of a fee?

A. For the reason that the leasehold had so many years to run much in excess of the life of the property, in other words, about 75 or 77 years. I disregarded any reversionary value whatever.

Q. In other words, you mean that your value would have been the same as if Mr. Jacobson owned the property and fee?

166 A. Substantially, in this instance on this land.

Q. Do you mean to tell me, Mr. Talbot, that you arrived at a valuation of $88,000 without deducting a single penny for the fact that this property was a leasehold under which the lessee was paying $1600 a year?

A. That is right. The report so states.

Q. I haven't seen any report. Don't you know as a matter of fact, Mr. Talbot, that the valuation of leasehold is based on entirely different formula than the valuations of fee on property?

A. There are numerous formulas for evaluation of each.

Q. Did you give any consideration, Mr. Talbot, with relation to the building with respect to the surrounding property?

A. I must assume that I did. That has been nearly four years since I inspected the property.

Q. You know where Drexel Boulevard is with respect to Cottage Grove Avenue?

A. Yes.

Q. You know it is one block east of Cottage Grove Avenue?

A. Yes.

Q. In 1938 and 1940, isn't it a fact that all the property west of Cottage Grove was largely inhabitated by 167 people of the colored race?

A. Oh, I won't presume to determine that per cent. I am told that that may be the case.

Q. Do you know what the tendency was with respect to the movement of the habitation of colored people at that time, whether the tendency was to move east?

A. To move wherever they were not.

Q. The closer you were to the district in which they resided, the more probable was the fact they might move into this section, isn't that right?

A. That may be assumed.

Q. As a general rule in real estate circles, would you say that was a factor that improved real estate value or depreciated real estate value?

A. If I may seem to be academic, on that there are instances when it does improve the income.

Q. You took no factor at all for that in your valuation?

A. Yes, I believe I may have also weighed that.

Q. You don't know?

A. No, I do not know.

Q. Don't you know also, Mr. Talbot, that Olcott's valuation is only for real estate that is unimproved, that it doesn't purport to value property that has already been improved or fully exploited by the erection of a building?

168 A. From year to year, Olcott's table of shown rates, has phenomenal changes in what purports to be the land value, or, as I understand, Olcott is what purports to be the consensus of opinion, due to improvement. It is, however, necessary that some such figure as this be used in the general consideration for valuation.

Q. Mr. Talbot, are you familiar with the number of properties in the city of Chicago outside of the so-called loop section that are held under a 99-year leasehold?

A. No, sir.

Q. Would you say that it was a usual or unusual thing for property in outlying sections to be operated under 99-year leases?

A. With the exception of the 63rd and Halsted district and perhaps north, I believe, I would say it would be unusual.

Q. As a matter of fact, at a location comparable to this location at 47th and Drexel it would be very unusual to have a leasehold property, is that right?

A. I cannot answer that question.

Q. Now, Mr. Talbot, assuming that Mr. Jacobson would want to acquire that fee simple title, he would have to pay something for it, would he?

A. You mean owning the leasehold.

Q. If he wanted to buy the fee from the owner of the fee simple, he would have to pay something for it, 169 wouldn't he?

A. Probably.

Q. Do you have any idea how that amount would be calculated by the owner of the fee and the person buying this leasehold? Would that be subject to excess of the income that is computed on the rate of the return by the fee simple owner?

A. The difference between the rate of return and ground rent.

Q. I don't know if I can make myself clear.

A. I believe you are not.

Q. Under the terms of the lease, are you familiar with the terms of the lease under which Mr. Jacobson owns his property?

A. I am not.

Q. Do you know what the ground rent is?

A. $1600 a year.

Q. That is paid annually but don't you know in valuing the fee, income of the fee only is capitalized on a certain basis?

A. Yes.

Q. Don't you also know that that capitalization factor is a rate of four or six per cent depending on the property?

A. Depending on the year and going rate of money.

Q. Money?

170 A. And many other factors.

Q. Would you say six per cent per annum of capitalization factor would be a fair capitalization of this building?

A. As a capitalization rate, I think it might be excessive.

Q. What would you say the proper rate would be?

A. Five per cent.

Q. At a rental of $1600 a year, the fee owners value of that fee would be $1600 times 20 on a five per cent basis?

A. On a five per cent basis.

Q. That would put a value of $32,000 on that fee?
A. Yes.
Q. Yes, according to your valuation, that purchase of that fee would not increase the value of Mr. Jacobson's leasehold whatsoever?
A. That would seem to so indicate.
Mr. Nierman: That is all.
Mr. Long: That is all.
The Court: You are excused.
(Witness excused.)
Mr. Long: Respondent rests.
Mr. Nierman: That is all.
The Court: Very well, this a case, I think, that would probably call for an opening brief by the petitioner and a reply brief by the Commissioner, and I will grant to
171 the petitioner a right to reply to the respondent's brief. The rule provides for forty-five days for filing the opening brief; Mr. Nierman, would that be sufficient time?
Mr. Nierman: I think, yes, your Honor, I think that is all right.
The Court: That would be, I would say November 20th, wouldn't it?
Mr. Nierman: If you made it December 1st, that would give me a little more time.
The Court: I have no objection to making it December 1st, and on account of the intervening holidays, I will grant the Commissioner until January 10, 1946.
Mr. Long: I have another brief that is due in the Horsting case at that time, your Honor, and I wonder if you could give me five days more on this one.
The Court: January 15th, you may have, Mr. Long, that will be January 15, 1946, and then petitioner may have until February 1, 1946, in which to file his reply brief to the respondent.
Mr. Nierman: What was that date, that last date?
The Court: February 1, 1946.
Mr. Nierman: Thank you very much, your Honor.
The Court: All right.
Mr. Long: Could you give me permission to withdraw the Commissioner's exhibits here for the purpose of
172 having photostatic copies made of them?
The Court: You may do that.

(Whereupon, at 4:40 o'clock p. m., Friday, October 5, 1945, the hearing in the above-entitled matter was closed.)

173 PETITIONER'S EXHIBIT NO. 1.

(Letterhead of McGraw & Company of Chicago, Illinois.)

October 4, 1945.

Mr. S. C. Nierman,
Room 2400—33 N. LaSalle St.,
Chicago, Illinois.

Dear Mr. Nierman:

In accordance with our phone conversation I am enclosing herewith copy of our Purchase and Sales Record of Jacobson Bldg. 5s.

We trust that this will serve your purpose.

Very truly yours,
McGraw & Company,
By D. L. Van Storm.

DVH.

174 Purchase And Sales Record of Jacobson Bldg. 1st L. H. Mtge (N. W. Cor. Drexel & 47th) Rate 5s Due 5-1-37.

Form 2C 2M 7-37 EP

Date 1939 Feb. 15	Bought From Or Sold To	Invoice No.	Cost Or Sale Price	Tax	Par Value Purchase	Par Value Sales	Bal. On Hand	Cost Purchases	Cost Sales	Bal. On Hand
	H. N. Samuels	12693	50	.72	1800		1800	899.28		899.28
	Lewis F. Jacobson	12694	50	.72		1800			899.28	

175 PETITIONER'S EXHIBIT NO. 2.

Confirmation

Anderson, Plotz & Company, Inc.
Listed and Unlisted Securities
39 South La Salle Street
Telephone Franklin 8467
Chicago

Ernest Zentner
7508 Kingston Av.
Chicago, Ill.

As Principal And For Our Own Account
We Confirm Our Purchases From You
Trade No. Date October 23, 1939

Bonds Or Shares	Security	Price
$180.00	Jacobson Bldg.	$76.50 for lot

Duplicate Confirmation

Amount	Tax	Total Amount
$76.50	.08	$76.42

Important—Read Carefully. Payment for all securities sold by us is due on presentation of this confirmation. Payment for all securities bought by us is due upon regular delivery of the securities to our office. In the event that payment in full for securities sold is not received by us promptly as noted above, we reserve the right at our option, and without further notice to you, either to cancel the sale or to sell said securities and hold you liable for any loss incurred. The securities above described are or may be hypothecated under circumstances which will permit the commingling thereof with securities carried for the account of other customers. Such commingling, however, if any, ceases upon payment by you for the above described securities.

We buy and sell securities for our own account only and act as principals in each transaction unless specifically

stated to the contrary. In any transaction where we act as agent we will, upon request, furnish the time when and place where the transaction took place and the name and address of the person with whom it was consummated.

Anderson, Plotz & Company, Inc.,
By .....

E. & O. E.

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176 PETITIONER'S EXHIBIT NO. 3.

Gross Rents And Expenses For Each Of The Years Taken From 1926 to 1940 On 47th & Drexel Taken From Income Tax Returns.

Year	Gross Income	Total Expenses	Net Income	Net Loss
1926	$34,105.61	$18,769.80	$15,335.81	
1927	34,105.61	20,991.20	13,114.41	
1928	31,384.04	26,547.10	4,836.94	
1929	28,441.46	19,096.16	9,338.30	
1930	29,303.40	19,567.44	9,735.96	
1931	25,051.06	17,925.46	7,125.60	
1932	17,017.64	15,732.34	1,285.30	
1933	14,402.41	19,461.71		$5,059.30
1934	13,904.78	17,615.68		3,710.90
1935	13,203.28	14,500.83		1,297.55
1936	15,694.22	14,510.50	1,183.72	
1937	25,051.06	17,925.46	7,125.60	
1938	16,550.00	15,416.05	1,233.95	
1939	16,520.75	15,413.64	1,107.11	
1940	15,578.50	13,859.09	1,719.41	

177 PETITIONER'S EXHIBIT NO. 4

State of Illinois, }
County of Cook. } ss.

Lewis F. Jacobson being first duly sworn upon oath deposes and says that the following represents all of the assets and liabilities of ~~this~~ affiant during the period from 1938 to 1940:

Assets.

Stocks and Bonds and Miscellaneous Assets, less Collateral Loans thereon, approximately	$ 50,000.00
Capital stock of Stony & Sixty-Third Building, Inc. (which owns the building at the Northwest corner of 63rd Street and Stony Island Avenue, Chicago, Illinois, approximately	250,000.00
Leasehold 47th & Drexel	40,000.00
Total Assets	$340,000.00

Liabilities.

Liabilities on Guaranty of Stony & Sixty-Third Building, Inc. Bonds	$360,000.00
47th & Drexel Bonds	51,750.00
Total Liabilities	$411,750.00

That the foregoing does not take into consideration any claims for fees for services rendered by affiant prior to said period.

Lewis F. Jacobson.

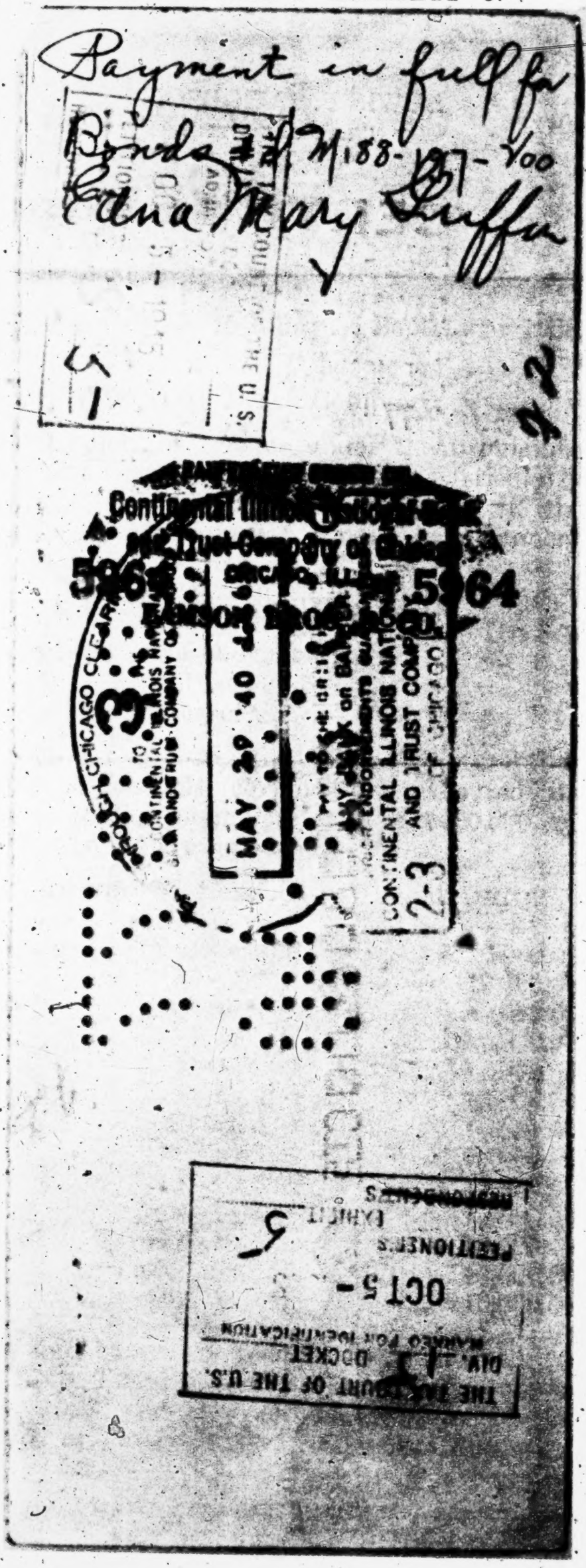
Subscribed And Sworn to before me this 25th day of September, A. D. 1945.

Agnes Stetcher,
Notary Public.

(Notarial Seal)

PETITIONER'S EXHIBIT 5.

PETITIONER'S EXHIBIT 5.



180 PETITIONER'S EXHIBIT NO. 6.

Forbearance Agreement.

This Agreement, dated this 15th day of September 1938, by and between

Chicago Title And Trust Company,

not personally but solely as trustee under the provisions of that certain trust deed hereinafter more particularly described, dated October 1, 1928, and recorded in the Recorder's Office of Cook County, Illinois, as document No. 10169000, as first party, and

Stony & Sixty-Third Building, Inc.,

an Illinois corporation, as second party,

Witnesseth:

Whereas, on October 1, 1928, Sixty-Third Stony Building Corporation, an Illinois corporation, executed its bonds in the aggregate principal amount of $400,000, of which the following bonds are outstanding:

Designation	Amount of Bonds	Maturity
October 1, 1932	41 to 50	$ 10,000.00
April 1, 1933	51 to 60	10,000.00
October 1, 1933	61 to 70	10,000.00
April 1, 1934	71 to 80	10,000.00
October 1, 1934	81 to 90	10,000.00
April 1, 1935	91 to 100	10,000.00
October 1, 1935	101 to 110	10,000.00
April 1, 1936	111 to 120	10,000.00
October 1, 1936	121 to 130	10,000.00
April 1, 1937	131 to 140	10,000.00
October 1, 1937	141 to 150	10,000.00
April 1, 1938	151 to 160	10,000.00
October 1, 1938	161 to 660	240,000.00

And Whereas, said bonds are secured by trust deed executed by said Sixty-Third Stony Building Corporation, dated October 1, 1928, and recorded in the office of the Recorder of Deeds of Cook County, Illinois, as document

No. 10169000, in Book 27138, at page 78, conveying to Chicago Title and Trust Company, as trustee, the following described property, to-wit:

Lots Fifteen (15) and Sixteen (16) and the South Forty (40) feet of Lots Fourteen (14) and Seventeen (17) in Block Two (2) in Park View, a Subdivision made by the Circuit Court Commissioners in Partition of the South Twenty (20) acres of that part of the South East quarter of the South East quarter of Section Fourteen (14), Township Thirty-eight (38) North, Range Fourteen (14), East of the Third Principal Meridian, in Cook County, Illinois, lying East of right of way of the Illinois Central Railroad, in the City of Chicago, County of Cook and State of Illinois;

And Whereas, Sixty-Third Stony Building Corporation was unable to pay bonds Nos. 41 to 110, inclusive, at their respective maturities, as above set forth, and the owners and holders of said matured bonds agreed by agreement dated December 30, 1935, to forbear from bringing any suit prior to October 1, 1937, to enforce the payment of the principal amount of said bonds Nos. 41 to 110, inclusive, or interest thereon, or to foreclose the lien of the trust deed securing the same; and

Whereas, bonds Nos. 111 to 160 matured at various dates between April 1, 1936 and April 1, 1938, and the remainder of the bonds will mature October 1, 1938; and

Whereas, second party has acquired title to the mortgaged premises and has assumed the payment of all of the outstanding bonds above referred to, together with the interest thereon; and

Whereas, second party has requested the owners and holders of the outstanding bonds to forbear from instituting any suit, action or other proceedings, either at law or in equity, prior to October 1, 1942, to recover the principal amount of the bonds or interest thereon or to foreclose the lien of the trust deed; and

Whereas, all or substantially all of the holders and owners of said bonds have agreed to forbear from instituting any suit, action or other proceedings as requested by second party prior to October 1, 1942, subject to the terms, covenants and provisions of second party hereinafter set forth;

Now, Therefore, in consideration of the agreements and

undertakings hereinafter set forth, the parties have agreed and do agree as follows, to-wit:

1. Second party agrees to pay the principal amount of all of the outstanding bonds on or before October 1, 1942, and to pay interest thereon at the rate of five per cent (5%) per annum from October 1, 1937, payable semi-annually in the manner hereinafter set forth. All of the outstanding bonds shall be registered by first party in the names of the respective owners thereof, and no new interest coupons shall be executed by second party to evidence the interest to become due on said bonds. Inter-
182 est shall be paid from time to time as hereinafter provided to the registered holders of the outstanding bonds.

2. Second party agrees to deliver to first party on or before the 15th day of each month during the term of this agreement, a detailed statement in form satisfactory to first party setting out the income and expenses arising in connection with the operation of the mortgaged premises during the calendar month immediately preceding, which statement shall be accompanied by receipted bills covering all disbursements. Such statement shall be certified as true and correct by Sidney C. Nierman or Lewis F. Jacobson, as officers of second party, and shall be sworn to and acknowledged before a Notary Public.

3. Second party agrees to deliver to first party, on or before the 15th day of each month during the term of this agreement, the entire net income as hereinafter defined arising from the operation of the mortgaged premises during the calendar month immediately preceding and as disclosed by the statement hereinabove in Section 2 referred to. "Net income", as used herein, shall mean the entire income received from all sources on account of the operation of the mortgaged premises, less usual and ordinary operating expenses. No unusual repairs and no capital expenditures for improvements or alterations shall be made without the consent in writing of first party. There shall be no deduction from net income for salaries or compensation to second party or its officers, directors or shareholders or to any other person, firm or corporation in connection with the management or operation of the mortgaged premises; provided, however, that a real estate agent may be employed by the second party and

compensation paid to such agent, but only with the written consent of first party, which consent first party in its absolute discretion may give or withhold.

4. It is understood and agreed that all funds paid to first party pursuant to the provisions of Section 3 hereof shall be held by first party and applied by it in such amounts and at such time or times as in its uncontrolled discretion it may determine, in the following order of priority:

(a) To the payment of the expenses of this forbearance, including expenses of first party and fees of its counsel and title report charges and expenses. There shall be no payment of any kind to second party or its attorneys.

(b) To the payment of or the establishment of a reserve on account of federal taxes and special assessments, such payments to be made to the extent that funds are available before such general taxes and special assessments become delinquent.

183 (c) To the payment of or the establishment of a reserve for the payment of interest on the outstanding bonds at the rate of five per cent per annum for the period commencing October 1, 1937, payable semi-annually on the first days of April and October in each year during the term of this agreement.

(d) To the payment of the principal amount of the bonds, such payments to be made as provided in section 3 hereof.

5. Application of funds paid to first party and to be applied to the reduction of the principal amount of the bonds pursuant to section 4 hereof, or to any of the other provisions of this agreement, shall be made by retirement of bonds by lot, conducted by the first party; provided, however, that first party shall not be required to conduct the drawing until such time as there is available therefor not less than $1000, and provided further that such bonds as drawn shall be paid in full with accrued interest in the order drawn, except that where the balance is insufficient to pay the last bond drawn, then such last bond drawn shall be endorsed with the payment of such balance, and the remainder of the principal amount of such bond shall be paid out of the next ensuing application on account of principal amount of the bonds before any further bonds are drawn.

6. Second party covenants and agrees that the amount to be applied to the payment and retirement of bonds out of the funds deposited with first party as provided in section 4, shall be not less than $10,000 for the year ending September 30, 1938, not less than $10,500 for the year ending September 30, 1939, not less than $11,000 for the year ending September 30, 1940, not less than $11,500 for the year ending September 30, 1941, and not less than $12,000 for the year ending September 30, 1942. In the event that the funds deposited with first party available for the payment of bonds shall be less for any year ending September 30 than the amounts herein provided for, second party covenants and agrees to pay or cause to be paid to first party, upon five days written notice, the amount of any deficiency for such year.

7. As additional security for the undertakings of second party contained in this forbearance agreement, second party has delivered to first party, duly assigned and endorsed for transfer, 99 shares of the capital stock of Parkland Hotel Company, an Illinois corporation. Second party hereby gives to first party and its attorney or assigns, full power to sell said collateral or any part thereof at any time or times hereafter, without advertising or demanding payment, upon mailing to second party and to Lewis F. Jacobson, 33 North La Salle Street, Chicago, Illinois, a five days notice in writing, at public or private sale or sales, in case second party shall default in any of its undertakings contained in this forbear-
184 ance agreement, and in case of any such sale first party or any of the holders or owners of any of the outstanding bonds may be the purchaser at such sale. In case of any such sale the proceeds, after payment of the costs and expenses connected with such collateral and sale and delivery thereof, may be applied to the obligation of the second party with respect to the payment of principal and interest on the outstanding bonds and the surplus, if any, shall be paid to the second party. In bidding at any such sale, the first party or the holder or holders of any outstanding bond or bonds may apply all or any part of the indebtedness of the second party evidenced by such bond or bonds toward the payment of the purchase price.

8. It is expressly understood and agreed that in accepting payments of net income to be applied by it on

account of the general taxes against the mortgaged premises; first party assumes no obligation whatever for the payment of such taxes and shall be obligated to use only ordinary care in connection with the administration of any funds so held by it.

9. Second party represents that the hotel portion of the property has been leased for a period of ten years, commencing January 1, 1938, to Parkland Hotel Company, an Illinois corporation, as lessee, at a fixed minimum rental of $30,000 per year, payable in equal monthly installments of $2500 per month, plus twenty-five per cent of the gross receipts of the lessee during each calendar year from rental or use of any space in the hotel premises in excess of $120,000. As additional security for undertakings of the second party contained in this forbearance agreement, second party simultaneously with the execution of this agreement has executed and delivered to first party an assignment of all of the right, title and interest of the lessor in said hotel lease. Second party covenants and agrees that no amendment or modification of said hotel lease shall be made without first obtaining the consent in writing of first party.

10. Second party represents that Parkland Hotel Company has executed and delivered to second party a chattel mortgage covering all of the personal property in the hotel, which chattel mortgage has been given to secure the obligations of the lessee under the terms of said hotel lease. As additional security for the undertakings of the second party contained in this forbearance agreement, second party has assigned and delivered to first party all of its right, title and interest in and to said chattel mortgage and the personal property therein described.

Second party covenants and agrees that on or before three years from the date of said chattel mortgage it will obtain a new chattel mortgage from Parkland Hotel Company or the then hotel lessee, coveting all of the personal property then in said hotel, and will thereupon assign all of its right, title and interest in and to said new chattel mortgage and the personal property therein described to first party as further security for the undertakings of the second party herein.

185 11. Simultaneously with the execution of this agreement, second party agrees to deliver or cause to be

delivered to first party for cancellation, outstanding bonds in the principal amount of $4000.

12. Second party, for itself, its successors, grantees and assigns, covenants and agrees that in case of default hereunder it will not apply for or avail itself of any appraisement, valuation, stay, extension, exemption or redemption laws or so-called moratorium laws now existing or hereafter enacted, in order to prevent or hinder the enforcement or foreclosure of the said trust deed and of the bonds secured thereby, and the second party, for itself, its successors, grantees and assigns, hereby waives all benefit of any and all such laws.

13. By the acceptance of this agreement, first party agrees that, except as hereinafter stated, it will forbear from bringing any suit at law or in equity prior to October 1, 1942, against second party, the guarantor of said bonds, Sixty-Third Stony Building Corporation, or any of them, to enforce the payment of the principal amount of said bonds or interest thereon or to foreclose the lien of the trust deed securing the same, or to exercise any right of entry or right to take possession of the mortgaged premises.

14. Upon the happening of any of the following events and after thirty days written notice thereof to second party, this agreement to forbear from bringing suit shall be void and of no further force and effect unless such default shall have been remedied prior to the expiration of said thirty days, to-wit:

(a) In the event of any default in the performance of any of the covenants or agreements contained in the bonds or trust deed and not herein expressly modified or waived.

(b) In the event of default by second party in the payment of taxes or of interest on the bonds or in the event of the failure of the second party to deposit the net income monthly or in the event of the default of second party to provide funds for the payment of bonds in the amounts hereinabove provided, provided, however, that in the event the balance of the net income deposited with first party for any one year ending September 30 available for the payment of bonds shall be in excess of the minimum amount which, in accordance with the provisions hereinabove set forth, is required to be paid on account of the

principal of bonds for such year, then in determining whether there is a default in any succeeding year or years, such excess shall be credited to any deficiency in such balance of income used for the payment of prin-186 cipal for any such succeeding year or years, and in the event that such deficiency for a previous year has been provided by second party or the guarantor hereinafter referred to, then, in such case the second party or said guarantor shall be reimbursed therefor to the extent of the excess as soon as such excess has been determined;

(c) In the event default shall be made under any of the other terms and provisions of this forbearance agreement.

(d) In the event of the appointment under the so-called Skarda Act or any similar law by any court of a tax receiver of the mortgaged premises.

(e) In the event of the failure of the hotel lessee to execute a new chattel mortgage as hereinbefore provided, or in the event of the failure of the second party to assign said new chattel mortgage to first party.

15. It is expressly agreed that the agreement of the first party to forbear from bringing any suit at law or in equity prior to the date hereinabove set forth, to enforce the payment of the bonds or to foreclose the trust deed shall not, nor shall anything herein contained, be construed as a novation, or as in any way modifying, altering, affecting or releasing the liability, whether primary or secondary, of any person for the payment of any sum evidenced by said bonds and or secured by said trust deed, but the right of recourse against every such person is hereby reserved.

16. It is further agreed that this agreement of forbearance shall not, nor shall anything contained herein, be construed to impair the security of the holders of the bonds under the trust deed, or to affect any rights, privileges or options of the first party provided for by the terms of said bonds or trust deed, except as herein specifically modified.

17. This agreement shall be binding upon and inure to the benefit of the parties hereto and their successors and assigns.

18. All notices which may be given or are required to be given under the terms of said trust deed may be given to the second party or its successors or assigns, by placing such notice in the United States mail, in a postage prepaid envelope, addressed to the second party or its respective successors or assigns, at their last known address. The deposit in the mail of such envelope containing such notice, addressed as aforesaid, shall be considered for all purposes full and sufficient compliance as to the giving of such notice, according to the terms of this forbear-
187 ance agreement or of the trust deed.

19. It is agreed that as to the performance of all of the undertakings herein set forth, time shall be the essence of this agreement.

20. This instrument is executed by first party not personally but as trustee under the above described trust deed, and it is expressly understood and agreed by the parties hereto, anything to the contrary notwithstanding, that each and all of the covenants, undertakings and agreements herein made are made and intended not as personal covenants, undertakings and agreements of the trustee for the purpose of binding it personally, but this instrument is executed and delivered by Chicago Title and Trust Company as trustee solely in the exercise of the powers conferred upon it as such trustee. No personal liability or personal responsibility is assumed by it nor shall at any time be asserted or enforced against the Chicago Title and Trust Company on account hereof or on account of any covenant, undertaking or agreement herein contained, either express or implied, all such personal liability, if any, being hereby expressly waived and released by second party and by all persons claiming by or through or under second party.

It is understood and agreed by the parties hereto that no act done by the trustees or any instrument executed by the trustee at any time under any of the provisions of this agreement shall in any manner impose any personal liability upon the trustee other than for its own wilful or wanton abuse of its powers and duties as trustee.

In Wifness Whereof first party has caused this instrument to be executed by its Vice President and its corporate seal to be hereto attached, attested by its Assistant Secretary, and second party has caused this instrument to be

executed by its President and its corporate seal to be hereto attached, attested by its Secretary, all as of the day and year first above written.

Chicago Title And Trust Company,
not personally but solely as trustee as aforesaid,
By M. N. Durkin,
Vice President.

Attest:

Frieda Tow,
(Seal) *Assistant Secretary.*

Stony & Sixty-Third Building, Inc.,
By Lewis F. Jacobson,
President.

Attest:

Sidney C. Nierman,
(Seal) *Secretary.*

188 The undersigned, the guarantor of the bonds referred to in the foregoing forbearance agreement, and being the registered holder of the shares of the capital stock of Parkland Hotel Company referred to in said forbearance agreement, does hereby consent to all the terms and provisions of said forbearance agreement.

The undersigned hereby guarantees the prompt payment by Stony & Sixty-Third Building, Inc. of all of the payments required to be made by it under the terms of the foregoing forbearance agreement, and guarantees the performance by Stony & Sixty-Third Building, Inc. of all of the other terms and provisions of said forbearance agreement.

The undersigned hereby waives presentment for payment, notice of nonpayment or dishonor, diligence in collection, and all formalities legally required to charge him with liability.

The undersigned further agrees that all of the benefits of this agreement and the right to enforce the provisions hereof, against the undersigned shall inure to the said Chicago Title and Trust Company, trustee, and to each and every holder of the bonds secured by the trust deed hereinabove described, according to their respective interests, and to the heirs, legal representatives, successors and assigns of each and every of them.

This guaranty shall be binding upon the undersigned and his heirs, legal representatives and assigns.

Neither the execution of the above and foregoing forbearance agreement nor this agreement of guaranty shall in any manner affect, modify or abrogate any of the terms and provisions of the guaranty dated October 7, 1928, heretofore executed by the undersigned.

Lewis F. Jacobson.

189 RESPONDENT'S EXHIBIT A.

Confirmation

Anderson, Plotz & Company, Inc.
Listed and Unlisted Securities
39 South LaSalle Street
Telephone Franklin 8467
Chicago

L. F. Jacobson
33 N. LaSalle St.
Chicago, Ill.
As Agent

We Confirm Our Purchase For Your Account:
Trade No. Date July 10, 1940

Duplicate Confirmation

Bonds or Shares	Security	Price
$500.	Reduced to $450. Jacobson Bldg. Bond	40

Our Commission

Amount	Charge	Total Amount
$180.00	$4.50	$184.50

Important—Read Carefully. Payment for all securities sold by us is due on presentation of this confirmation. Payment for all securities bought by us due upon regular delivery of the securities to our office. In the event that payment in full for securities sold is not received by us promptly as noted above, we reserve the right at our option, and without further notice to you, either to cancel the sale or to sell said securities and hold you liable for any

loss incurred. The securities above described are or may be hypothecated under circumstances which will permit the commingling thereof with securities carried for the account of other customers. Such commingling, however, if any, ceases upon payment by you for the above described securities.

We buy and sell securities for our own account only and act as principals in each transaction unless specifically stated to the contrary. In any transaction where we act as agent we will, upon request, furnish the time when and place where the transaction took place and the name an address of the person with whom it was consummated.

Anderson, Plotz & Company, Inc.
By .....

E. & O. E.

190 Confirmation 14310

Anderson, Plotz & Company, Inc.
Listed and Unlisted Securities
29 South LaSalle Street
Telephone Franklin 8467
Chicago

L. F. Jacobson
33 N. LaSalle St.
Chicago, Ill.
As Agent

We Confirm Our Purchase For Your Account:
Trade No. Date July 10, 1940

Bonds or Shares	Security	Price
$500.	Reduced to $450. Jacobson Bldg. Bond	40

Amount	Commission	Total Amount
$180.00	$4.50	$184.50

We beg to enclose herewith the securities described above; receipt of which please acknowledge on enclosed blank. No. D 167

Important—Read Carefully. Payment for all securities sold by us is due on presentation of this confirmation. Payment for all securities bought by us due upon regular delivery of the securities to our office. In the event that pay-

ment in full for securities sold is not received by us promptly as noted above, we reserve the right at our option, and without further notice to you, either to cancel the sale or to sell said securities and hold you liable for any loss incurred.

Transactions with Anderson, Plotz & Company, Inc., are subject to the agreement that any controversies arising in connection therewith shall be settled by arbitration, and judgment upon any award rendered may be entered in the Highest Court, State or Federal, having jurisdiction; such arbitration shall be in accordance with the rules, then obtaining, of the American Arbitration Association, if then in existence and if not in existence, of the Arbitration Committee of the Illinois Chamber of Commerce of the State of Illinois, if then in existence.

We buy and sell securities for our own account only and act as principals in each transaction unless specifically stated to the contrary.

Anderson, Plotz & Company, Inc.
By.....

E. & O. E.

191 Trade Memorandum

14310
Trader 2 Date 7/10/40

	Price	Amount
Sold to L. F. Jacobson Address 33 N. LaSalle		
Full Description: 500-450 Jacobson Bond Memo for Cashier	40 +	450 Com.

192 RESPONDENT'S EXHIBIT B.

Confirmation

Anderson, Plotz & Company, Inc.

Listed and Unlisted Securities
39 South LaSalle Street
Telephone Franklin 8467
Chicago

L. F. Jacobson
33 N. LaSalle St.
Chicago, Ill.
As Agent

We Confirm Our Purchase For Your Account:
Trade No. Date Sept. 23, 1940

Bonds or Shares	Security	Price
$450.	Jacobson Bldg. 5s 1942	40 F

Duplicate Confirmation

Amount	Our Commission Charge	Total Amount
$180.00	$5.00	$185.00

Important—Read Carefully. Payment for all securities sold by us is due on presentation of this confirmation. Payment for all securities bought by us due upon regular delivery of the securities to our office. In the event that payment in full for securities sold is not received by us promptly as noted above, we reserve the right at our option, and without further notice to you, either to cancel the sale or to sell said securities and hold you liable for any loss incurred. The securities above described are or may be hypothecated under circumstances which will permit the commingling thereof with securities carried for the account of other customers. Such commingling, however, if any, ceases upon payment by you for the above described securities.

We buy and sell securities for our own account only and act as principals in each transaction unless specifically

stated to the contrary. In any transaction where we act as agent we will, upon request, furnish the time when and place where the transaction took place and the name and address of the person with whom it was consummated.

E. & O. E.

Anderson, Plotz & Company, Inc.
By .....

193 Confirmation

Anderson, Plotz & Company, Inc.

Listed and Unlisted Securities
29 South LaSalle Street
Telephone Franklin 8467
Chicago

L. F. Jacobson
33 N. LaSalle St.
Chicago, Ill.
As Agent

We Confirm Our Purchase For Your Account:
Trade No. Date Sept. 23, 1940.

Bonds or Shares	Security	Price
$450.	Jacobson Bldg. 5s 1942	40 F

Amount	Commission	Total Amount
$180.00	5.00	$185.00

We beg to enclose herewith the securities described above; receipts of which please acknowledge on enclosed blank. No. D 153 No cpns

Important—Read Carefully. Payment for all securities sold by us is due on presentation of this confirmation. Payment for all securities bought by us is due upon regular delivery of the securities to our office. In the event that payment in full for securities sold is not received by us promptly as noted above, we reserve the right at our option, and without further notice to you, either to cancel the sale or to sell said securities and hold you liable for any loss incurred.

Transactions with Anderson, Plotz & Company, Inc., are subject to the agreement that any controversies arising in connection therewith shall be settled by arbitration, and judgment upon any award rendered may be entered in the Highest Court, State or Federal, having jurisdiction; such arbitration shall be in accordance with the rules, then obtaining, of the American Arbitration Association, if then in existence and if not in existence, of the Arbitration Committee of the Illinois Chamber of Commerce of the State of Illinois, if then in existence.

We buy and sell securities for our own account only and act as principals in each transaction unless specifically stated to the contrary.

Anderson, Plotz & Company, Inc.
By

E. & O. E.

194 Trade Memorandum

14767

Trader 2 Date 9 25 40

Price Amount

Sold to L. F. Jacobson
Address 33 N. LaSalle (State) 1616

Full Description: 480 Jacobson Bldg. 5-X No +.5.00 Com.
192.00
5.00
197.00

Memo. for Cashier

195 6 T. C. No. 133.

The Tax Court of the United States

Lewis F. Jacobson, Petitioner, v. *Commissioner of Internal Revenue, Respondent.*

Docket No. 4189. Promulgated May 10, 1946.

1. Petitioner is the owner in Chicago, Illinois of a leasehold and buildings thereon. In 1925 petitioner borrowed $90,000 on such property and executed his negotiable bonds therefor. Some of the bonds have

been paid off and retired from time to time and the interest has at all times been paid. January 1, 1938, $51,750 of such bonds was still outstanding. In the years 1938, 1939 and 1940 petitioner acquired some of these bonds at less than their face value. Some of them were acquired by petitioner directly from the bondholders themselves after negotiations with them. Some were acquired by purchases through the secretary of a bondholders' committee and through security houses. *Held*, that as to the bonds acquired by petitioner through direct negotiations with the bondholders he is not taxable on the gain therefrom under the doctrine of *Helvering* v. *American Dental Co.*, 318 U. S. 322. *Held, further*, that petitioner is taxable on the gain realized in the purchases from bondholders through the secretary of the Bondholders' committee and the security dealers under the doctrine of the Supreme Court in *United States* v. *Kirby Lumber Co.*, 284 U. S. 1, he being at all times solvent.

2. On the evidence, *held*, petitioner is entitled to a deduction in each of the taxable years 1939 and 1940 of $750 expended in entertaining clients in the course of his law business and paying for meals for employees for which he was not reimbursed by his law firm.

196 3. On the evidence, *held*, the expenses incurred in operating petitioner's automobile in 1939 and 1940 were incurred one half for petitioner's personal use and the use of his family and are not deductible; that one half of the expenditures was incurred in the use of petitioner's automobile for business purposes and is deductible.

Sidney C. Norman, Esq., for the petitioner.

David E. Long, Esq., for the respondent.

The Commissioner has determined deficiencies in petitioner's income tax for the years 1938, 1939 and 1940, respectively, as follows: $842.99, $708.19 and $2,416.79. The petitioner contests parts of these deficiencies by the following assignments of error:

(a) The Commissioner erred in failing to allow automobile and entertainment expenses in connection with his practice of law, aggregating $597.97 for 1938, $793.34 for 1939 and $750.55 for 1940.

(b) The Commissioner erred in holding that the acquisition by the petitioner of his mortgage obligations, at a price lower than the face value thereof during each of the years in question, represented taxable income to the petitioner during any of said years.

(c) The Commissioner erred in failing to hold that the holders of the bonds, being creditors of the petitioner, gratuitously and because of debtor's straitened circumstances, diminishing security and other facts, accepted from petitioner an amount less than the face value thereof.

(d) The Commissioner erred in failing to hold that the payment for said bonds at an amount less than the face value thereof did not create any taxable income to the petitioner.

At the hearing petitioner abandoned his assignment of error as to the $597.97 automobile and entertainment expenses disallowed by the Commissioner for the year 1938. He continues to press his assignment of error as to the disallowance by the Commissioner of these expenses of $793.34 for 1939 and $750.55 for 1940. Several adjustments made by the Commissioner in his deficiency notice were not contested in the petition.

197 Finding of Fact.

The petitioner is an individual who resides in Chicago, Illinois. He filed his income tax returns with the Collector of Internal Revenue for the first district of Illinois.

In June 1922 petitioner purchased a half interest in the building located at the northwest corner of 47th Street and Drexel Boulevard, Chicago, Illinois, and leasehold running for 99 years from May 1, 1914, and in March 1923 he purchased the remaining half interest therein. In December 1925 a substantial addition was made to the building. The total cost to the petitioner of the leasehold and improvements and the addition was $116,580.56. When the petitioner became the owner of all the interest in the above leasehold and building, he allocated, for the purpose of depreciation, $76,580.56 to the building and $40,000 to the leasehold.

On or about May 1, 1925, petitioner borrowed the sum of $90,000 from the South Side Trust and Savings Bank.

and the petitioner and his wife executed 200 bonds secured by a mortgage trust deed on the leasehold and building to evidence and secure the payment of the loan. The proceeds of the loan were used to pay off the existing encumbrance on the property, to pay for an addition to the building which cost $16,250 and to pay the necessary brokerage commission and expenses in connection with the loan, leaving a small surplus over and above the several items above enumerated which was paid to the petitioner.

The bonds were payable at the rate of $2,500 semiannually to and including November 1, 1931, and the balance of $57,500 on May 1, 1932, with interest at 6½ percent per annum. All of the bonds which became due up to and including November 1, 1931, were paid at or about their respective maturity dates.

198 On June 8, 1931, the South Side Trust and Savings Bank failed to open its doors.

A bondholders' committee was formed for the bondholders who had purchased bonds on petitioner's building. On May 1, 1932, petitioner applied to the bondholders' committee and the bondholders themselves for an extension of the time of payment of this loan. He communicated with the individual bondholders, as well as the committee, and procured an extension to May 1, 1937 of the payment of the principal of the bonds. At no time did petitioner default in the payment of interest on the bonds.

During this extended period checks for interest were issued by petitioner directly to the holders of the bonds and were delivered to them by R. W. Gerding, secretary of the committee. Bondholders frequently visited the petitioner at his office in connection with the collection of their interest and to find out the status of the property. Petitioner kept a list of the bondholders, the dates of payment of their interest, the numbers of their bonds and their addresses, and was fully informed as to who his creditors on this bond issue were and where they were, and they were kept informed, from time to time, as to petitioner's general financial condition.

In 1937 petitioner again procured an extension of time of the payment of the bonds to 1942, and in that connection paid 10 percent on account of the principal of the bonds, leaving an unpaid balance as of January 1, 1938 of $51,750.

On April 9, 1938, petitioner purchased $450 of bonds from Beatrice Johnson and Margaret Finn, owners thereof, and

and paid therefor $202.50. The checks of Sidney C. Nierman (a partner of the petitioner, whose office was the same as the petitioner's) were issued to the owners of the bonds with an endorsement that they were in full payment of
199 the purchase price of said bonds. Petitioner reimbursed Sidney C. Nierman for this payment, as Nierman was acting for petitioner in the transaction and the owners of the bonds knew that he was.

On June 9, 1938, petitioner purchased $3,600 of bonds from Beatrice Johnson and Margaret Finn, owners thereof, under the same circumstances as shown in the foregoing paragraph and paid therefor $1,620.

On August 17, 1938, petitioner purchased $900 of bonds from Beatrice Johnson, owner thereof, under the same circumstances as shown in the foregoing paragraphs and paid therefor $405.

Summarizing the transactions in 1938, the total unpaid principal amount of the bonds purchased by petitioner during 1938 was the sum of $4,950 and the amount paid by petitioner therefor was the sum of $2,227.50, or a difference of $2,722.50.

In 1938 petitioner purchased $900 of bonds from Dr. Kemp in the unpaid principal sum of $900 for the sum of $957. The Commissioner (by evident mistake) included the sum of $43 as income in connection with said Kemp purchase on the assumption that the unpaid amount of the bonds was $1,000 instead of $900, and on that assumption included in income for the year 1938 the sum of $2,767.50, instead of $2,722.50 shown above.

On February 15, 1939, petitioner purchased $1,800 of bonds owned by H. N. Samuels through McGraw & Company, who were representing Samuels in the transaction, and paid therefor the sum of $900.

On June 16, 1939, petitioner purchased $450 of bonds directly from Dolly Stoecker, the owner thereof, and paid therefor $225.

On October 23, 1939, petitioner purchased $180 of bonds of which Ernest Zentner was the owner, at the price of $86.50. The purchase was made through the brokerage firm of Anderson, Plotz & Company. Petitioner paid the firm a fee of $10 for making the purchase.

200 Summarizing the transactions of 1939, the total unpaid principal amount of bonds purchased by the petitioner was the sum of $2,430 and the amount paid by

petitioner therefor was the sum of $1,211.50, or a difference of $1,218.50.

On April 4, 1940, petitioner purchased through R. W. Gerding, secretary of the bondholders' committee, $270 of bonds of which Jens Hendrickson was the owner and paid therefor the sum of $130. A fee of $7.50 was paid by petitioner to Gerding for making the purchase.

On May 21, 1940, petitioner purchased $450 of bonds of which Garnet Grayson was the owner and paid the sum of $210. The transaction was handled by R. W. Gerding, secretary of the bondholders' committee and a service charge of $7.50 was paid to Gerding for his services.

On May 23, 1940, petitioner purchased $2,700 of bonds of which Edna Mary Griffin was the owner and paid the sum of $1,080. The transaction was handled by R. W. Gerding, secretary of the bondholders' committee and a service charge of $27 was paid to Gerding for his services.

On June 19, 1940, petitioner purchased $1,800 of bonds of which Mary Melody was the owner and paid the sum of $720. The transaction was handled by R. W. Gerding, secretary of the bondholders' committee and a service charge of $18 was paid him for his services.

On July 1, 1940, petitioner purchased $450 of bonds of which William Verhey was the owner and paid the sum of $200. The bonds were purchased through Anderson, Plotz & Company. The $200 which petitioner paid for these bonds included a fee of $15 to Anderson, Plotz & Company for their services.

On July 3, 1940, petitioner purchased $450 of bonds of which John F. Sullivan was the owner and paid the sum of $200. The purchase was made through Anderson, Plotz & Company and the purchase price of $200 included a fee of $25 to Anderson, Plotz & Company for their services.

On July 10, 1940, petitioner purchased $450 of bonds of which Edward Foley was the owner and paid the sum of $184.50. The purchase was made through Anderson, Plotz & Company. Petitioner paid a fee of $4.50 to Anderson, Plotz & Company for making the purchase.

On September 23, 1940, petitioner purchased $450 of bonds of which Edward Foley was the owner and paid the sum of $185. The purchase was made through Anderson, Plotz & Company and petitioner paid that firm a fee of $5.00 for making the purchase.

Summarizing the transactions in 1940, the total unpaid

principal amount of the bonds purchased during 1940 by petitioner was the sum of $7,020 and the amount paid by petitioner therefor was the sum of $2,950 or a difference of $4,065.

There was never any listing of the bonds or a quoted price. Nobody was buying these bonds except petitioner.

The gross income from the real estate located at 47th Street and Drexel Boulevard, Chicago, Illinois, in 1926 was $34,105.61 and the net income $15,335.81. The gross and net income from the property depreciated from year to year from 1926 through 1940, so that in 1938, 1939 and 1940, the gross and net income were as follows:

1938	
Gross income	$16,550.00
Net income	1,233.95
1939	
Gross income	16,520.75
Net income	1,107.11
1940	
Gross income	15,578.50
Net income	1,719.41

The above amounts of net income were after deduction of expenses, depreciation and interest on bonds.

202 The fair market value of this leasehold and buildings for the year 1938 was the sum of $80,000. It was the same in 1939 and 1940, less depreciation on the buildings which accrued subsequent to January 1, 1938. At all times during the years 1938, 1939 and 1940 the value of the buildings and leasehold exceeded the bonded indebtedness which was against the property.

In addition to the rental income from the above-mentioned leasehold and buildings, petitioner had gross income from a partnership, dividends, interest, and from the Chicago Title and Trust Co., during the years 1938, 1939 and 1940, as follows:

Year	From Partnership	Interest	Dividends	Chicago Title & Trust Co.	Totals
1938	$35,613.41	$ 812.50	$1,964.94	0	$38,390.85
1939	32,686.90	863.38	2,094.50	0	35,644.78
1940	26,900.11	819.78	4,672.20	$2,887.50	35,279.59
Totals	$95,200.42	$2,495.66	$8,731.64	$2,887.50	$109,315.22

Petitioner owned considerable other property in Chicago outside of the leasehold and buildings here in question. The details of this other property which petitioner owned in the taxable years are in the record but it is deemed unnecessary to set forth further details as to such property here. On the strength of the showing of petitioners' assets and liabilities, we find petitioner was solvent during each of the taxable years 1938, 1939 and 1940.

Facts as to Petitioner's Claimed Deductions for Entertainment Expenses for Clients, Etc.

In each of the years 1939 and 1940 petitioner was a partner of the firm of Jacobson, Nierman & Silbert, attorneys at law. Petitioner received from this firm for each of these years the aggregate sum of $2,850 in cash which was charged to his account on the firm's books. Petitioner used these cash sums withdrawn from his firm for his own 203 day to day personal expenses and for expenses in connection with business of the petitioner for the payment of lunch and supper for employees of his law firm and for the entertainment of clients. Petitioner expended at least $750 in each of the taxable years 1939 and 1940 in the entertainment of employees and clients and was not reimbursed therefor by the firm or by the clients. He kept no itemized account of these expenditures.

All of petitioner's household, living and family expenses and major personal expenses were paid by checks of petitioner and are not here involved.

The gross income of the firm of which petitioner produced most of the business during each of these years was between $75,000 and $80,000.

Automobile Expenses.

In 1939 petitioner expended for operating his automobile the sum of $1,030.04 and in 1940 the sum of $1,051.66 and he deducted in his returns two thirds of that expense as business expense. The Commissioner in his determination of the deficiencies allowed only one third of these deductions. One half of these automobile expenses was incurred in the personal use of the automobile by petitioner and his family. One half of such expenses was incurred by petitioner in the

use of the automobile for business purposes for his law firm in making trips to see clients, to interview witnesses and other similar uses. Petitioner received no reimbursement from his law firm or his clients for these expenditures.

204 Opinion.

BLACK, *Judge*: The main issue in this proceeding and one which is common to all three of the taxable years is whether petitioner is taxable on the difference between the face value of certain bonds upon which he was liable as the issuer and the price for which he purchased some of these bonds during each of the taxable years. The facts as to the amounts of such bonds purchased and the price which was paid for them are not in dispute. The controversy between the parties concerns itself only with the manner and form and effect of the purchases.

It is respondent's contention that it is a case controlled by *United States* v. *Kirby Lumber Co.* 284 U. S. 1 and petitioner is taxable on all the gain realized. On the other hand, petitioner contends that the bonds were all purchased under such circumstances and the arrangements with the creditors from which said bonds were purchased were such as to bring the case within Supreme Court's decision in *Helvering* v. *American Dental Co.* 318 U. S. 322, a later case than the *Kirby Lumber Co.* case. We have endeavored to set out in our findings of fact a full statement of the facts and circumstances connected with each purchase in each of the taxable years. We shall not repeat these facts here. Suffice it to say these facts show that some of the bonds were acquired by petitioner through direct conferences and negotiations between him and the bondholders with whom he was acquainted. These conferences were either with petitioner and the bondholder personally or between petitioner's half brother and law partner, Sidney Neirman representing petitioner, and the bondholder. As to these
205 purchases we hold that the doctrine of the *American Dental Co.* decision applies and petitioner is not taxable on that part of the gain which the Commissioner has determined.

The facts also show that petitioner acquired a number of the outstanding bonds through R. W. Gerding, secretary of a bondholders' committee and through two security houses in Chicago and paid commissions on such purchases. As to

these we think the situation is analogous to that in *Fifth Avenue-14th Street Corporation*, 2 T. C. 516, where the taxpayer acquired certain of its debentures at discount figures on the open market. As to such purchases we held that the doctrine of *American Dental Co.* did not apply.

It is petitioner's contention in the instant case that there was no open market for the sale of his bonds. It is true that there was no open market for the bonds in the sense that they were bought and sold on any securities exchange or in an over-the-counter market. However, the manner by which petitioner acquired a number of his bonds through R. W. Gerding, secretary of the bondholders' committee, and through the security dealers, Anderson, Plotz & Co., and through McGraw and Company is close akin to purchase in the open market, if indeed it does not properly fall within that sort of classification. As to these purchases the personal element we think necessary to make a gift within the meaning of the *American Dental Co.* case was absent.

206 As an example of what we mean by the above statement, one of the transactions involved in the instant case was the purchase by petitioner through R. W. Gerding, secretary to the bondholders' committee, of $2,700 face value of bonds owned by Edna Mary Griffin at 40 cents on the dollar, amounting to $1,080. Petitioner paid Gerding $27 for making this purchase in his behalf and claims that we should not recognize the gain to him under the doctrine of the *American Dental Co.* case, *supra*. With reference to this transaction, Dr. George D. Griffin, husband of Edna Mary Griffin, testified on behalf of respondent. His testimony in substance was: he had practiced medicine in Chicago, Illinois for 37 years; he had custody of his wife's bonds, kept them in a vault and always represented his wife in bond transactions; that he negotiated the sale in question with the bondholders' committee and received for the bonds 40 cents on the dollar flat. He further testified he was not acquainted with the petitioner and probably had never seen him before. While Dr. Griffin was the only witness called by respondent to testify as to any particular bond transaction, we think this testimony is illustrative of the nature of the purchases which were made for petitioner's account by Gerding and by the two firms who were dealers in securities. On the basis of the evidence which is in the record, we cannot hold that these purchases fall within the ambit of the *American Dental Co.* case.

Therefore, applying what we have said above to petitioner's bond purchases for each of the respective taxable years, we make the following holdings:

207 As to 1938 petitioner has proved that all the bonds which he purchased in that year were after direct negotiations and agreements with the bondholders. He did not purchase through any third party and paid no commissions or other fees. We hold that the doctrine of the *American Dental Co.* case applies to these purchases.

As to 1939 only $450 face value of the bonds purchased in that year for $225 falls within the above classification. This purchase was made by the petitioner after direct negotiation with the owner of the bond, Dolly Stoecker. All the rest of the purchases which petitioner made in 1939 were either through R. W. Gerding, secretary of the bondholders' committee, or through the two dealers in securities which we have named in our findings of fact. In each instance, save one, in making these purchases petitioner paid a fee to the one making the purchase in his behalf. For reasons already stated we hold that petitioner is taxable on the gain which the Commissioner has determined resulted from these particular purchases, except the one which petitioner made direct from Dolly Stoecker.

As to 1940 the evidence shows that all the purchases made by petitioner in this particular year were made either through R. W. Gerding, secretary of the bondholders' committee, or through Anderson, Plotz & Co., security dealers. In each instance petitioner paid a fee to the one acting for him in making the purchase. No bonds were purchased in 1940 by petitioner dealing direct with the owners. Therefore, for reasons already stated, we sustain the Commissioner as to all purchases in 1940.

208 Petitioner contends in the alternative that at the time he purchased said bonds he was insolvent and was still insolvent after the purchases were made, citing *Dallas Transfer & Terminal Warehouse Company* v. *Commissioner*, 70 Fed. (2d) 95. It requires no citation of authorities, of course, that in establishing this contention the burden of proof is on petitioner. We think he has failed to sustain that burden. It is true that petitioner did establish by the evidence that there had been considerable decline in the value of property which he owned and in the revenues which it had been producing but petitioner failed to establish to our satisfaction that he was insolvent. In fact we think

that the weight of the evidence establishes that he was solvent in each of the taxable years and we have so found. Take the property in question against which the bonded indebtedness existed. It yielded petitioner a small net income in each of the taxable years, after all expenses, depreciation and the interest on the bonds were deducted. Also petitioner had considerable net income in each of the taxable years from his law practice, as shown in our findings of fact.

We hold, after considering all the evidence, that petitioner was solvent in each of the taxable years and that the doctrine of the *Dallas Transfer & Terminal Warehouse Company* case, *supra*, has no application. Petitioner's alternative contention is not sustained.

Entertainment Expenses for Clients and Employees.

The testimony of petitioner is to the effect that in each of the taxable years, 1939 and 1940, he drew $2,850 from his law firm to defray certain personal expenses of his own such as taking meals downtown while working at nights and also to defray expenses of entertaining clients and employees of the firm. Petitioner testified that he expended not more than $1,000 of this amount in each of the taxable years for his own meals, tips, etc. and that the balance was expended in entertaining customers and in paying for lunches and suppers of employees of the firm for which he was not reimbursed by the firm. While petitioner in effect claims that he spent $1,850 in each of the taxable years for these purposes, he only claims a deduction of $750 in each of the taxable years 1939 and 1940 for these entertainment expenses. Petitioner did not keep any record of separate items of these expenditures. However, he has testified at length about them and how and under what circumstances he made them and we are convinced that he expended at least $750 for these purposes and we have so found in our findings of fact.

In a computation under Rule 50 the Commissioner should allow petitioner a deduction of a total of $750 in each of the taxable years 1939 and 1940 for these entertainment expenses. Of this amount, we do not know how much the Commissioner has already allowed in his determination of the deficiencies. The detailed statement which usually accompanies the deficiency notice is not attached to the petition.

Some of the statement is attached but the details which show the adjustments that the Commissioner has made have been omitted from the statement.

Automobile Expenses.

The uncontradicted evidence in the record is that during 1939 petitioner expended $1,030.04 in the operation of his automobile and $1,051.61 in 1940 for the same purpose. Petitioner claims that at least two-thirds of these expenditures were incurred in the firm's business for which he was not reimbursed and that not more than one-third of such expenditures was incurred in operating the automobile for the personal use of petitioner and his family. Respondent's contention is that petitioner kept no record of his automobile expenses, except as to amounts expended for all purposes and that he should fail for a lack of evidence to support the deductions which he claims.

We have carefully examined and considered petitioner's testimony as to these automobile expenditures and we have decided that one half of the total amount expended in 1939 and 1940 should be attributed to personal expenses and not deductible and one half should be attributed to use for business expenses and therefore deductible. Apparently the Commissioner in his determination of the deficiencies has allowed as a deduction one third of these expenses and has disallowed two thirds. In a recomputation under Rule 50 one half of such expenses should be allowed as a deduction and the other one half should be disallowed because incurred for petitioner's own personal benefit and convenience and that of his family. Cf. *Albert Nelson*, 6 T. C. , promulgated April 18, 1946.

Reviewed by the Court.

Decision will be entered under Rule 50.

SMITH, J., dissents.

211 KERN, J., dissenting: In its opinion in *Helvering v. American Dental Co.*, 318 U. S. 322, the Supreme Court cited, with approval, *United States v. Kirby Lumber Co.*, 284 U. S. 1, and unmistakably indicated that it considered that the two cases were distinguishable. I submit that the majority opinion is incorrect in finding the distinction to be the impersonal character of the transaction, and in applying

to the facts of the instant case the sole criterion of whether "the bonds were acquired by petitioner through direct conferences and negotiations between him (taxpayer's agent) and the bondholders with whom he was acquainted", for the purpose of determining whether the doctrine of the *American Dental Co.* case, or the doctrine of the *Kirby Lumber Co.* case, should be controlling.

The true point of distinction between the two cases is, to my mind, found in the following language in the *American Dental Co.* opinion:

> "Gifts however, is a generic word of broad connotations * * *. Its plain meaning in its present setting denotes, it seems to us, *the receipt of financial advantages gratuitously.*
>
> * * * * * * *
>
> The fact that the motives leading to the cancellations were those of business, or even selfish, if it be true, is not significant. *The forgiveness was gratuitous, a release of something to the debtor for nothing and sufficient illegible the cancellation here gifts within the statute.* (Emphasis supplied).

Thus, the criterion to be applied in determining whether the *American Dental Co.* case or the *Kirby Lumber Co.* case controls the transactions here in question is not whether the bonds were acquired by petitioner through direct conferences and negotiations with bondholders who were personal acquaintances of its officers, but whether the acquisition of these bonds by petitioner at prices below their face value constituted "the receipt of financial advantages 212 gratuitously" so that it might be said that "the forgiveness (of the excess of the face value over the price paid) was gratuitous * * * and sufficient to make the cancellation here gifts within the statute."

Applying the criterion of distinction to the facts of the instant case, it is apparent that none of the transactions here in question were gratuitous. Petitioner's bonds, which it acquired, were not payable until 1942. It purchased them in 1938, 1939 and 1940 by paying to the bondholders an amount smaller than the amount which it would have been obliged to pay if the bonds had been held until maturity. The payment of a part of a debt before it is due constitutes consideration which will support a promise of the creditor to waive or forgive the balance of the debt. *See Crane v.*

Gore, 85 Fed. (2d) 291, 294; Williston on Contracts, Rev. Ed. 1936, Vol. I, section 121. Since a consideration existed by reason of the equivalent of the payment of an obligation before maturity, the transactions can not be considered as gratuitous within the meaning of the *American Dental Co.* case regardless of the fact that petitioner's officers were personally acquainted with the bondholders who received these payments.

The majority opinion appears to go on the theory that all transactions carried on directly with personal acquaintances must be gratuitous. It is my opinion that while all gratuitous transactions will normally be carried on directly between personal acquaintances, not all transactions carried on directly between personal acquaintances are gratuitous. The instant case is an example.

To make the tax consequence to petitioner corpo-
213 ration of the acquisition of its bonds before maturity at less than their face value depend on each case of acquisition of a bond solely upon the degree of acquaintance shown to exist between an officer of petitioner and the particular bondholder, and the personal or impersonal character of the negotiations leading to its acquisition, is to give an effect to the *American Dental Co.* decision which, in my opinion, was not intended by the Supreme Court and which its opinion does not compel.

It may also be pointed out that the basic facts here presented show a typical *Kirby Lumber Co.* case: the borrowing of money, the issuance of bonds to evidence the indebtedness thereby created, and the acquisition of these bonds by the debtor corporation from the bondholders for payments less than those carried for on the face of the bonds, at a time when the value of the assets of the debtor corporation was in excess of its liabilities. Such a state of facts can not be said to be analogous to "a reduction of sale price" to be "treated as a readjustment of the contract rather than as a gain". The Supreme Court in the *American Dental Co.* case said:

> In *United States* v. *Kirby Lumber Co.*, 284 U. S. 1, 52 S. Ct. 4, 76 L. Ed. 131, the taxpayer purchased its own bonds at a discount. It was held taxable on the increase in net assets which resulted.

It later used language in its opinion which may be construed as characterizing the *Kirby Lumber Co.* case as one

of "financial betterment through the purchase by a debtor of its bonds in an arms-length transaction." If we combine the two characterizations we find the Supreme
214 Court considering the *Kirby Lumber Co.* case as one in which the debtor corporation purchased its own bonds in an arms-length transaction as a discount and thus bettered itself financially. The instant case can be accurately described in exactly the same words. Only by distorting the meaning of "an arms-length transaction" can this case be distinguished. It is impossible for me to believe that the Supreme Court intended the words "an arms-length transaction" to exclude those transactions carried on "through direct conferences and negotiations" between the officers of the debtor corporation and bondholders with whom they happened to be personally acquainted. TURNER, LEECH, ARNOLD, and HARLAN, *JJ.*, agree with this dissent.

(Seal)

215 THE TAX COURT OF THE UNITED STATES.

(Caption—4189)

RESPONDENT'S COMPUTATION FOR ENTRY OF DECISION.

(Filed Jun. 12, 1946.)

The attached proposed computation is submitted on behalf of the respondent, to The Tax Court of the United States, in compliance with its opinion determining the issues in this proceeding.

This computation is submitted in accordance with the opinion of the Tax Court, without prejudice to the respondent's right to contest the correctness of the decision entered herein by the Tax Court, pursuant to the statutes in such cases made and provided.

(Signed) J. P. Wenchel, J. D. K.
Chief Counsel, Bureau of Revenue.

Of Counsel:
John D. Kiley,
Division Counsel.
David F. Long,
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Bureau of Internal Revenue.

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Statement.

In re: Lewis F. Jacobson
1216 Madison Park
Chicago, Illinois

Docket No. 4489

Income Tax Liability

Year	Tax Liability	Tax Assessed	Deficiency
1938	$ 2,580.85	$2,318.62	$ 262.23
1939	3,261.07	2,472.55	788.52*
1940	7,833.60	5,034.51	2,799.09*
Totals	$13,675.52	$9,825.68	$3,849.84

The adjustments shown in the attached schedules have been made in accordance with the opinion of the Tax Court of the United States promulgated May 10, 1946 for decision under Rule 50.

Claims for increased deficiencies in the amounts of $788.52 and $2,799.09, in lieu of the amounts of $708.19 and $2,446.70 set forth in the notice of deficiency, for the respective taxable years 1939 and 1940, are hereby asserted by the Commissioner pursuant to the provisions of Section 272(e) of the Internal Revenue Code.

Schedule 1

Net Income

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	Year: 1938
Net income as shown in deficiency notice dated December 16, 1943	$28,602.88
Net Income, adjusted	25,837.38
Adjustment	$ 2,765.50
Decrease:	
Other income	$ 2,765.50

Schedule 2

Explanation of Adjustment

Petitioner's income has been decreased by $2,765.50, representing the gain previously included on bonds acquired through direct negotiations with the bondholders.

Schedule 3

Computation of Tax

Net income, schedule 1		$25,837.38
Less: Personal exemption	$2,500.00	
Credit for dependent	400.00	2,900.00
Surtax net income		$22,937.38
Less: Earned income credit		1,400.00
Balance subject to normal tax		$21,537.38
Normal tax at 4% on $21,537.38		$ 861.50
Surtax on $22,937.38		1,719.35
Total normal tax and surtax		$ 2,580.85
Income tax assessed:		
Original Acct. #206743	$2,172.76	
Additional June 1940 Acct. #512242	145.86	2,318.62
Deficiency		$ 262.23

Schedule 4

Net Income

	Year: 1939
Net income as shown in deficiency notice dated December 16, 1943	$28,694.01
Net income, adjusted	29,061.14
Adjustment	$ 367.13
Increase:	
(a) Entertainment expense	$763.80
Decrease:	
(b) Other Income $225.00	
(c) Auto expense 171.67	396.67
	$ 367.13

218 Schedule 5

Explanation of Adjustments

(a) An allowance of $750.00 has been made for entertainment expenses instead of $1,513.80 ($1,963.80 less $450.00) the amount previously allowed.

(b) The gain of $225.00 previously included in petitioner's income on bonds acquired through direct negotiations with the bondholders has been eliminated herein.

(c) Automobile expenses have been allowed in an amount of $515.02 (½ of $1,030.04) instead of $343.35 the amount previously allowed, which adjustment results in a decrease of $171.67 in income.

Schedule 6

Computation of Tax

Net income, schedule 4		$29,061.14
Less: Personal exemption	$2,500.00	
Credit for dependent	400.00	2,900.00
Balance surtax net income		$26,161.14
Less: Earned income credit		1,400.00
Balance subject to normal tax		$24,761.14
Normal tax at 4% on $24,761.14		$ 990.45
Surtax on $26,161.14		2,270.62
Total income tax		$ 3,261.07
Income tax assessed:		
Original Acct. #208622	$2,286.28	
Amend. Apr. 1942 #900520	186.27	2,472.55
Deficiency		$ 788.52

Claim for the increased deficiency in the amount of $788.52 in lieu of the amount of $708.19 set forth in the notice of deficiency, is hereby asserted by the Commissioner pursuant to the provisions of Section 272(e) of the Internal Revenue Code.

Schedule 7

Net Income

	Year: 1940
Net income as shown in deficiency notice dated December 16, 1943	$34,412.62
Net income, adjusted	35,351.89
Adjustment	$ 939.27
Increase income	
(a) Entertainment expense $1,114.54	
Decrease	
(b) Automobile expense 175.27	$ 939.27

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Schedule 8

Explanation of Adjustments

(a). An allowance of $750.00 has been made for entertainment expenses instead of $1,864.54 ($2,264.54 less $400.00) the amount previously allowed.

(b) Automobile expenses have been allowed in an amount of $525.83 (½ of $1,051.66) instead of $350.56 the amount previously allowed, which adjustment results in a decrease of $175.27 in income.

Schedule 9

Computation of Tax

Net income, schedule 7		$35,351.89
Less: Personal exemption	$2,000.00	
Credit for dependent	100.00—	2,100.00
Surtax net income		$33,251.89
Less: Earned income credit		1,400.00
Normal tax net income		$31,851.89
Normal tax at 4% on $31,851.89		$1,274.08
Surtax on $33,251.89		5,653.12
Total normal tax and surtax		$ 6,927.20

Alternative Tax

Net income, schedule 7		$35,351.89
Add: Net long-term loss		2,775.00
Ordinary net income		$38,126.89
Less: Personal exemption	$2,000.00	
Credit for dependent	100.00	2,100.00
Surtax net income		$36,026.89
Less: Earned income credit		1,400.00
Balance subject to normal tax		$34,626.89
Normal Tax at 4% on $34,626.89		$ 1,385.08
Surtax on $36,026.89		6,568.87
Partial tax		$ 7,953.95
Less: 30% of $2,775.00 (net long term loss)		832.50
Alternative tax		$ 7,121.45
Total normal tax and surtax		$ 6,927.20
Income tax liability (greater amount)		$ 7,121.45
Defense tax, 10% of $7,121.45		712.15
Total income and defense taxes		$ 7,833.60
Income tax assessed:		
Original Acct. #214967	$3,954.50	
Amend. June 1942 #300019	1,079.92	5,034.51
Deficiency		$ 2,799.09

Claim for the increased deficiency in the amount of $2,799.09, in lieu of the amount of $2,416.79 set forth in the notice of deficiency, is hereby asserted by the Commissioner pursuant to the provisions of Section 272(e) of the Internal Revenue Code.

220 THE TAX COURT OF THE UNITED STATES.

(Caption—4189)

PETITIONER'S OBJECTION TO RESPONDENT'S COMPUTATION FOR ENTRY OF DECISION AND ALTERNATIVE COMPUTATION AND MOTION TO TRANSFER HEARING ON OBJECTION TO CHICAGO, ILL.

(Filed Jun. 24, 1946.)

Petitioner, Lewis F. Jacobson, objects to Respondent's computation for entry of decision because it is not in accordance with the opinion of this Court, and because in no event can increased deficiencies be now claimed.

Petitioner submits herewith the attached alternative computation in compliance with the opinion of The Tax Court determining the issues in this proceeding and the reasons therefor, but without prejudice to Petitioner's right to contest the correctness of the decision entered herein by The Tax Court pursuant to the statutes in such cases made and provided.

Petitioner further moves that any hearing on the computation should be held at Chicago, Illinois, when the next calendar is called in said city, or at such other time convenient to the Court, for reasons set forth in the attached suggestions.

s Sidney C. Nierman,
Counsil for Petitioner,
Room 2400, 33 North LaSalle St.,
Chicago 2, Illinois.

221 Statement.

In Re: Lewis F. Jacobson
1216 Madison Park
Chicago, Illinois

Docket No. 4189

Year	Tax Liability	Tax Assessed	Deficiency
1938	$ 2,580.85	$2,318.62	$ 262.23
1939	3,044.94	2,472.55	572.39
1940	7,217.18	5,034.51	2,182.67
Totals	$12,842.97	$9,825.68	$3,017.29

The adjustments shown in the attached schedules have been made in accordance with the opinion of The Tax Court of the United States promulgated May 10, 1946, for decision under Rule 50.

222 Year: 193

Schedules 1, 2 and 3 of Respondent's computation are correct and are herein reiterated.

Schedule 4

Net Income

		Year: 1939
Net income as shown in deficiency notice dated December 16, 1943		$28,694.01
Net income, adjusted		28,047.34
Adjustment (decrease)		$ 646.67
Decrease:		
(a) Entertainment expense	$450.00	
(b) Other income	225.00	
(c) Automobile expense	171.67	$ 646.67

Schedule 5

Explanation of Adjustments

(a) An allowance of $1,963.80 has been made for entertainment expenses instead of $1,513.80, the amount previously allowed, which adjustment results in a decrease of $450.00 in income.

(b) The gain of $225.00 previously included in Petitioner's income on bonds acquired through direct negotiations with the bondholders has been eliminated herein.

(c) Automobile expenses have been allowed in an amount of $515.02 (½ of $1,030.04) instead of $343.35 the amount previously allowed, which adjustment results in a decrease of $171.67 in income.

Schedule 6

Computation of Tax

Net income, Schedule 4		$28,047.34
Less: Personal exemption	$2,500.00	
Credit for dependent	40.00	2,900.00
Balance surtax net income		$25,147.34
Less: Earned income credit		1,400.00
Balance subject to normal tax		$23,747.34
Normal tax at 4% on $23,747.34		$ 949.89
Surtax on $25,147.34		2,095.05
Total income tax		$ 3,044.94
Income tax assessed:		
Original Acct. #208622	$2,286.28	
Amend. Apr. 1942 #900520	186.27	2,472.55
Deficiency		$ 572.39

223

Year: 1940

Schedule 7

Net Income

Net income as shown in deficiency notice dated December 16, 1943		$34,412.62
Net income, adjusted		33,837.35
Adjustment (decrease)		$ 575.27
Decrease income		
(a) Entertainment expense	$400.00	
(b) Automobile expense	175.27	$ 575.27

Schedule 8.

Explanation of Adjustments.

(a) An allowance of $2,264.54 has been made for entertainment expenses instead of $1,864.54, the amount previously allowed, which adjustment results in a decrease of $400.00.

(b) Automobile expenses have been allowed in an amount of $525.83 (½ of $1,051.66) instead of $350.56, the amount previously allowed, which adjustment results in a decrease of $175.27 in income.

Schedule 9.

Computation of Tax.

Net income, Schedule 7		$33,837.35
Less: Personal exemption	$2,000.00	
Credit for dependent	100.00	2,100.00
Surtax net income		$31,737.35
Less: Earned income credit		1,400.00
Normal tax net income		$30,337.35
Normal tax at 4% on $30,337.35		$ 1,213.49
Surtax on $31,737.35		5,161.20
Total normal tax and surtax		$ 6,374.69

Alternative Tax.

Net income, Schedule 7		$33,837.35
Add: Net long-term loss		2,775.00
Ordinary net income		$36,612.35
Less: Personal exemption	$2,000.00	
Credit for dependent	100.00	2,100.00
Surtax net income		$34,512.35
Less: Earned income credit		1,400.00
Balance subject to normal tax		$33,112.35
Normal tax at 4% on $33,112.35		$ 1,324.49
Surtax on $34,512.35		6,069.08
Partial tax		$ 7,393.57
Less: 30% of $2,775.00 (net long term loss)		832.00
Alternative tax		$ 6,561.07
224 Total normal tax and surtax		$ 6,374.69
Income tax liability (greater amount)		6,561.07
Defense tax 10% of $6,561.07		656.11
Total income and defense taxes		$ 7,217.18
Income tax assessed:		
Original Acct. #214967	$3,954.59	
Amend. June 1942 #300019	1,079.92	5,034.51
Deficiency		$ 2,182.67

Suggestions in Support of the Objections to the Respondent's Computation of Taxes and of the Foregoing Alternative Computations by Petitioner.

The sole difference between the computations of the Respondent and the Petitioner arises out of the amount to be allowed for entertainment expenses for the years 1939 and 1940. The Respondent has substituted for the amount previously allowed by him for the year 1939 of $1,513.80, the sum of $750.00, and for the amount previously allowed by him for the year 1940 of $1,864.54, the sum of $750.00. Thus, the Respondent has notwithstanding the decision by this Court in favor of the Respondent on entertainment expenses, reduced the amount previously allowed instead of increasing it. He has seized upon the statement made by the Court on Page 15 of its opinion to the effect that the Court did not know how much the Commissioner had already allowed in his determination of the deficiencies to base a contention that the Court only intended to allow an aggregate of $750.00 for all entertainment expenses. This position is taken by the Respondent notwithstanding that the sole issue before the Court was whether the Commissioner improperly reduced the amount claimed in the return by the Petitioner of $750.00 in each year for entertainment expenses of which he did not have records of separate items on which issue the Court decided in favor of the Petitioner.

That this was the sole issue is amply manifested by the revenue agent's return which was confirmed by the Commissioner's notice of deficiency. Please see excerpt from the report of the agent in charge dated May 6, 1942 attached to petition for redetermination filed in this Court which is as follows:

"Taxpayer has a fair record of most of his entertainment expenses but at the end of the year estimates $750.00 in entertainment expense that he cannot substantiate. He evidently does have some expenses that cannot be substantiated, and it is recommended that he be allowed $300.00 as a deduction from income. The balance should be disallowed in accordance with Section 24 (a) (1) of the Internal Revenue Code."

Also see excerpt from the preliminary report of examination of agent in charge dated September 17, 1942, with respect to the year 1940 attached to the petition for re-

determination of tax filed in this Court in which the Commissioner disallows $400.00 of the amount claimed.

The notice of deficiency also attached to the petition for redetermination shows in paragraph (c) of the explanation of adjustments for each of the years, that the revenue agent's report was confirmed, but it combines the automobile and entertainment expenses and disallows $793.34 for the year 1939 which is the aggregate of $343.34 disallowed by the Internal Revenue Agent in Charge, as aforesaid, for automobile expenses and the $450.00 disallowed for entertainment expenses, and for the year 1940 it combines the automobile expense and entertainment expense and shows the disallowance at $750.55, which is are aggregate of $350.55 disallowed by the Internal Revenue Agent in Charge, as aforesaid, for automobile expenses and the $400.00 disallowed for entertainment expenses. The reason for the disallowance of a portion of these entertainment expenses is given in the agent's report above quoted, which was the disallowance of a portion of the item of $750.00 taken by the Petitioner as a deduction without any supporting itemized records and upon which issue this Court expressly determined the Commissioner was wrong and the allowance should be $750.00 as to each of said years. Consequently, the only computation that could be made is to increase the allowance by the amount previously disallowed by the Commissioner which was $450.00 as to the year 1939, and $400.00 as to the year 1940, which has been done by the Petitioner in the foregoing computation of tax. The remaining amount of entertainment expenses claimed by Petitioner for the years 1939 and 1940 in his return, were for club dues and expenses for which the Petitioner issued checks and of which he had a complete record which was exhibited to the examining agent and approved by him and by the Commissioner. This appears in the official report of proceedings before this Court at page 64 to 66 and counsel for Respondent stated specifically that there was no objection to the method of proof on that subject. (See top of page 66.)

At no time, either on the trial or in the briefs filed in this Court, did the Commissioner assert that there was any other question before this Court, than the determination as to the amount to be allowed to the Petitioner for unrecorded itemized expenses of $750.00 in each of the years, but because this Court expressed some doubt as to

the amount disallowed for that item, it is seized upon by the Commissioner to reduce the allowance which he previously approved and for which he made no contention was not proper.

226 The total difference in tax resulting from the several computations for both the years 1939 and 1940 is the sum of $832.55. The expense of making a trip to Washington, D. C., from Chicago, Illinois, where the Petitioner and his counsel reside, and the time consumed in such trip, makes it almost prohibitive in view of the amounts involved to have the hearing on these objections in Washington. We believe that the foregoing suggestions of the Petitioner clearly demonstrate that his computation is the correct one and should be adopted by the Court, but if there is any doubt concerning the same, Petitioner requests that the hearing on these objections be had at Chicago, Illinois, when the next calendar of this Court is called at that place, or at any other time convenient to the Court.

Respectfully submitted,

/s/ Sidney C. Nierman,
Counsel for Petitioner,
Room 2400, 33 North LaSalle St.,
Chicago 2, Illinois.

State of Illinois }
County of Cook } ss.

Sidney C. Nierman, being duly sworn, on oath deposes and says that he is counsel for Petitioner in the above entitled cause; that he has knowledge of the facts stated in the foregoing objections and suggestions and that the same are true.

/s/ Sidney C. Nierman.

Subscribed and Sworn to before me this 22nd day of June, A. D., 1946.

/s/ Henry Schuchat,
Notary Public.

(Seal)

227 THE TAX COURT OF THE UNITED STATES.

(Caption—4189)

REVISED RESPONDENT'S COMPUTATION FOR ENTRY OF DECISION.

(Filed Aug. 1, 1946.)

The attached proposed computation is submitted, on behalf of the respondent, to The Tax Court of the United States, in compliance with its opinion determining the issues in this proceeding.

This computation is submitted in accordance with the opinion of the Tax Court, without prejudice to the respondent's right to contest the correctness of the decision entered herein by the Tax Court, pursuant to the statutes in such cases made and provided.

(Signed) J. P. Wenchel,
J. D. K.

J. P. Wenchel,
Chief Counsel, Bureau of Internal Revenue.

Of Counsel:
John D. Kiley,
Division Counsel.

David F. Long,
Special Attorney,
Bureau of Internal Revenue.

228

Statement.

In re: Lewis F. Jacobson
1216 Madison Park
Chicago, Illinois

Docket: #4189

Income Tax Liability.

Year	Tax Liability	Tax Assessed	Deficiency
1938	$ 2,580.85	$2,318.62	$ 262.23
1939	3,097.44	2,472.55	624.89
1940	7,379.98	5,034.51	2,345.47
Totals	$13,058.27	$9,825.68	$3,232.59

The adjustments shown in the attached schedules have been made in accordance with the opinion of The Tax Court of the United States promulgated May 10, 1946 for decision under Rule 50.

229

Year: 1938

Schedule 1.

Net Income.

Net income as shown in deficiency notice dated December 16, 1943	$28,602.88
Net income, adjusted	25,827.38
Adjustment	$ 2,765.50
Decrease:	
Other income	$ 2,765.50

Schedule 2.

Explanation of Adjustment.

Petitioner's income has been decreased by $2,765.50, representing the gain previously included on bonds acquired through direct negotiations with the bondholders.

Schedule 3.

Computation of Tax.

Net income, schedule 1		$25,837.38
Less:		
Personal exemption		
Credit for dependent	400.00	2,900.00
Surtax net income		$22,937.38
Less:		
Earned income credit		1,400.00
Balance subject to normal tax		$21,537.38
Normal tax at 4% on $21,537.38		$ 861.50
Surtax on $22,937.38		1,719.35
Total income tax liability		$ 2,580.85
Income tax assessed:		
Original, Account #206743	$2,172.76	
Additional, June 1940 Account #512242	145.86	2,318.62
Deficiency		$ 262.23

Schedule 4.

Net Income.

230 Year: 1939

Net income shown in deficiency notice dated December 16, 1943	$28,694.01
Net income, adjusted	28,397.34
Adjustment	$ 396.67
Decrease:	
(a) Other income	$ 225.00
(b) Auto expense	171.67
Total decrease	$ 396.67

Schedule 5.

Explanation of Adjustments.

(a) The gain of $225.00 previously included in petitioner's income on bonds acquired through direct negotiations with the bondholders has been eliminated herein.

(b) Automobile expenses have been allowed in an amount of $515.02 (½ of $1,030.04) instead of $343.35, the amount previously allowed, which adjustment results in a decrease of $171.67 in income.

Entertainment expenses have been allowed in the amount of $1,513.80 ($1,963.80 less $450.00), the amount previously allowed in the deficiency notice.

Schedule 6.

Computation of Tax.

Net income, schedule 4		$28,297.34
Less: Personal exemption	$2,500.00	
Credit for dependent	400.00	2,900.00
Surtax net income		$25,397.34
Less: Earned income credit		1,400.00
Income subject to normal tax		$23,997.34
Normal tax 4% on $23,997.34		$ 959.89
Surtax on $25,397.34		2,137.55
Total income tax		$ 3,097.44
231 Income tax assessed:		
Original, Account =208622	$2,286.28	
Amend. Apr. 1942 =900520	186.27	2,472.55
Deficiency		$ 624.89

Schedule 7

Net Income

	Year: 1940
Net income shown in deficiency notice dated December 16, 1943	$34,412.62
Net income, adjusted	34,237.35
Adjustment	$ 175.27
Decrease:	
Automobile expense	$ 175.27

Schedule 8

Explanation of Adjustment

Automobile expenses have been allowed in an amount of $525.83 (½ of $1,051.66) instead of $350.56, the amount previously allowed.

Entertainment expenses have been allowed in the amount of $1,864.54 ($2,264.54 less $400.00), the amount previously allowed in the deficiency notice.

Schedule 9

Computation of Tax

Net income, schedule 7		$34,237.35
Less: Personal exemption	$2,000.00	
Credit for dependent	100.00	2,100.00
Surtax net income		$32,137.35
Less: Earned income credit		1,400.00
Income subject to normal tax		$30,737.35
Normal tax 4% on $30,737.35		$ 1,229.49
Surtax on $32,137.35		5,285.33
Total Normal tax and surtax		$ 6,514.82

232 Alternative Tax

Net income schedule 7		$34,237.35
Plus: Net long-term loss		2,775.00
Ordinary net income		$37,012.35
Less: Personal exemption	$2,000.00	
Credit for dependent	100.00	2,100.00
Surtax net income		$34,912.35
Less: Earned income credit		1,400.00
Income subject to normal tax		$33,512.35
Normal tax 4% on $33,512.35		$ 1,340.49
Surtax on $34,912.35		6,201.08
Partial tax		$ 7,541.57
Less: 30% of $2,775.00 (net long-term loss)		$ 832.50
Alternative tax		$ 6,709.07
Total normal tax and surtax		$ 6,514.82
Tax liability (greater amount)		$ 6,709.07
Defense tax		670.91
Income tax liability		$ 7,379.98
Income tax assessed:		
Original Account #214967	$3,954.59	
Amend. June 1942 #300019	1,079.92	5,034.51
Deficiency		$ 2,345.47

233 THE TAX COURT OF THE UNITED STATES.

(Caption—4189)

DECISION.

This proceeding was called from the Hearing Calendar of August 7, 1946, for settlement under Rule 50, pursuant to the determination of the Court as set forth in its Findings of Fact and Opinion promulgated May 10, 1946. No appearance or contest was made on behalf of counsel for petitioner at the hearing. Petitioner filed a recomputation of tax on June 24, 1946, and respondent filed his revised recomputation of tax on August 1, 1946. Upon consideration of said recomputations, it is

Ordered and Decided: That there are deficiencies in income tax for the calendar years 1938, 1939, and 1940 in the respective amounts of $262.23, $624.89 and $2,345.47.

/s/ Eugene Black,
Judge.

(Seal)

Enter:

Entered Aug. 7, 1946.

234 IN THE UNITED STATES CIRCUIT COURT OF APPEALS.

For the Seventh Circuit.

Commissioner of Internal Revenue, *Petitioner on Review,* vs. Lewis F. Jacobson, *Respondent on Review.*	T. C. Docket No. 4189

PETITION FOR REVIEW.

Filed Oct. 31, 1946.

The Commissioner of Internal Revenue, holding office by virtue of the laws of the United States, hereby petitions the United States Circuit Court of Appeals for the Seventh Circuit to review the decision entered by The Tax Court of the United States on August 7, 1946, ordering and deciding that there are deficiencies in income tax for the calendar years 1938 and 1939 in the respective amounts

of $262.23 and $624.89. This petition for review is filed pursuant to the provisions of Sections 1141 and 1142 of the United States Internal Revenue Code.

Lewis F. Jacobson, respondent on review, is an individual residing in Chicago, Illinois, and filed his income tax returns for the calendar years 1938 and 1939 with the Collector of Internal Revenue for the First District of Illinois, located at Chicago, Illinois, which collection district is within the jurisdiction of the United States Circuit Court of Appeals for the Seventh Circuit, wherein this review is sought.

(Sgd) Sewall Key, CAR
Acting Assistant Attorney General.
(Sgd) J. P. Wenchel,
Chief Counsel,
Bureau of Internal Revenue,
Attorneys for Petitioner on Review.

Of Counsel:
Claude R. Marshall
Special Attorney,
Bureau of Internal Revenue.

CRM/has 10/28/46

235 IN THE UNITED STATES CIRCUIT COURT OF APPEALS.
(Caption—4189)

STATEMENT OF POINTS TO BE RELIED UPON ON REVIEW.

Filed Oct. 31, 1946.

Now comes the petitioner on review in the above-entitled proceeding and says that the following is a concise statement of points upon which he intends to rely on review:

That the Tax Court of the United States erred:

1. In holding and deciding that taxpayer is not subject to income tax on the difference between the face value of certain bonds upon which he was liable as the issuer and the price for which he purchased these bonds during the taxable years involved as a result of direct conferences and negotiations between taxpayer or his half-brother and law partner with bondholders with whom they were personally acquainted.

2. In failing to hold and decide that taxpayer is subject to income tax on the difference between the face value of the aforementioned bonds upon which he was liable as the issuer and the price for which he purchased them during the years involved.

3. In holding and finding that, under the particular conditions and circumstances involved, the acquisition of the aforementioned bonds by and for the taxpayer at prices below their face value was gratuitous and constituted gifts within the meaning of the provisions of the revenue laws and controlling decisions.

236 4. In failing to hold and decide that, under the particular conditions and circumstances involved, the acquisition of the aforementioned bonds by and for the taxpayer at prices below their face value was not gratuitous and did not constitute gifts within the meaning of the provisions of the revenue laws and controlling decisions.

5. In holding and concluding that the gain realized from the acquisition of the aforementioned bonds is not taxable under the doctrine enunciated by the United States Supreme Court in *Helvering* v. *American Dental* Co., (1943) 318 U. S. 322.

6. In failing to hold and conclude that the gain realized from the acquisition of the aforementioned bonds is taxable under the doctrine enunciated by the United States Supreme Court in *United States* v. *Kirby Lumber Co.*, (1931) 284 U. S. 1.

7. In holding and deciding that gain in the amounts of $2,765.50 and $225.00 realized in the respective years 1938 and 1939 by the taxpayer through direct negotiations with bondholders of personal acquaintance is not subject to tax in the years 1938 and 1939, respectively.

8. In failing to hold and decide that the gain in the amounts of $2,765.50 and $225.00 realized in the respective years 1938 and 1939 by the taxpayer through direct negotiations with bondholders of personal acquaintance is subject to tax in the years 1938 and 1939, respectively.

9. In that its opinion and decision are not in accordance with the law and the regulations and are not supported by substantial evidence.

10. In ordering and deciding that there are deficiencies in income tax for the years 1938 and 1939 only in the amounts of $262.23 and $624.89, respectively.

237 11. In failing to order and decide that there are deficiencies in income tax for the years 1938 and 1939 in the amounts of $842.39 and $672.14, respectively.

(Sgd) Sewall Key, CAR
Acting Assistant Attorney General.

(Signed) J. P. Wenchel, CAR
Chief Counsel,
Bureau of Internal Revenue,
Counsel for Petitioner on Review.

Of Counsel:
Claude R. Marshall,
Special Attorney,
Bureau of Internal Revenue.

CRM:bas 10/24/46

238 In the United States Circuit Court of Appeals.

(Caption—4189)

NOTICE OF FILING PETITION FOR REVIEW AND STATEMENT OF POINTS TO BE RELIED UPON.

Filed Nov. 8, 1946.

To: Lewis F. Jacobson
30 North LaSalle Street
Chicago, Illinois

You are hereby notified that the Commissioner of Internal Revenue did, on the 31st day of October 1946, file with the Clerk of The Tax Court of the United States, at Washington, D. C., a petition for review by the United States Circuit Court of Appeals for the Seventh Circuit of the decision of the Tax Court heretofore rendered in the above-entitled cause, together with a Statement of Points to be relied upon on Review. A copy of each of the aforementioned documents as filed are hereto attached and served upon you.

Dated this 31st day of October 1946.

(Signed) J. P. Wenchel, CAR
Chief Counsel,
Bureau of Internal Revenue,
Counsel for Petitioner on Review.

Personal service of the above and foregoing notice, together with a copy of the petition for review and a copy of the Statement of Points to be relied upon on Review, is hereby acknowledged this 5th day of November, 1946.

s/ Lewis F. Jacobson,
Respondent on Review.

239 IN THE UNITED STATES CIRCUIT COURT OF APPEALS.

(Caption—4189)

PETITION FOR REVIEW.

Filed Nov. 6, 1946.

Lewis F. Jacobson hereby petitions the United States Circuit Court of Appeals for the Seventh Circuit to review the decision entered by the Tax Court of the United States on August 7, 1946, ordering and deciding that there are deficiencies in income tax of Lewis F. Jacobson, this petitioner, for the calendar years 1939 and 1940 in the respective amounts of $624.89 and $2,345.47. This petition for review is filed pursuant to the provisions of Sections 1141 and 1142 of the United States Internal Revenue Code.

Lewis F. Jacobson, this petitioner, is an individual residing in Chicago, Illinois, and filed his income tax returns for the calendar years 1939 and 1940 with the Collector of Internal Revenue for the First District of Illinois, located at Chicago, Illinois, which collection 240 district is within the jurisdiction of the United States Circuit Court of Appeals for the Seventh Circuit, wherein this review is sought.

Sidney C. Nierman
Attorney for this Petitioner and Respondent on Review.
33 North LaSalle Street
Chicago, Illinois

241 IN THE UNITED STATES CIRCUIT COURT OF APPEALS.

(Caption—4189)

STATEMENT OF POINTS TO BE RELIED UPON ON REVIEW BY LEWIS F. JACOBSON, RESPONDENT ON REVIEW.

Filed Nov. 6, 1946.

Now comes the respondent on review in the above entitled proceeding and says that the following is a concise statement of points upon which he intends to rely on review, in connection with his petition for review.

That the Tax Court of the United States erred:

1. In holding and deciding that taxpayer is subject to income tax on the difference between the face value of certain bonds upon which he was liable as the issuer and the price for which he purchased these bonds during the taxable years involved from the holders of said bonds.

2. In failing to hold and decide the taxpayer is not subject to income tax on the difference between the face value of the aforementioned bonds upon which he was liable as the issuer and the price for which he purchased them during the years involved.

242 3. In holding and finding that under the particular conditions and circumstances involved the acquisition of the aforementioned bonds by and for the taxpayer at prices below their face value resulted in a gain to the taxpayer contrary to the doctrine enunciated by the United States Supreme Court in *Helvering* v. *American Dental Co.* (1943), 318 U. S. 322.

4. In failing to hold and decide that under the particular conditions and circumstances involved the acquisition of the aforementioned bonds by and for the taxpayer at prices below their face value resulted in no gain to the taxpayer and therefore was not taxable under the doctrine enunciated by the United States Supreme Court in *Helvering* v. *American Dental Co.* (1943), 318 U. S. 322.

5. In holding and deciding that a gain was realized from the acquisition of the aforementioned bonds which was taxable under the doctrine enunciated by the United States Supreme Court in *United States* v. *Kirby Lumber Co.* (1931), 284 U. S. 1.

6. In holding and deciding that gain in the amounts of $993.50 and $4,065.00 was realized in the respective years 1939 and 1940 by the taxpayer in the acquisition of

bonds through an agent when both the taxpayer and the holders of the bonds knew they were dealing with each other and the holders intended that the taxpayer should acquire the same at prices below their face value gratuitously.

7. In failing to hold and decide that all purchases made by the taxpayer during the years in question constituted an acceptance by taxpayer's creditors, gratuitously and without any other consideration, of an amount less than the unpaid balance of said bonds in full payment thereof, and therefore resulted in no taxable income.

8. In failing to hold and decide that the bonds acquired by the taxpayer were issued by him to refinance existing encumbrances assumed by him at the time he purchased the real estate securing said bonds and for the costs of erecting additions upon said real estate, and therefore the payment by taxpayer for said bonds of a sum less than the face amount thereof resulted in an adjustment of the cost of said real estate and not in any taxable gain.

9. In that its opinion and decision are not in accordance with the law and the regulations and are not supported by substantial evidence.

10. In failing to find that the holders of the bonds acquired by the taxpayer knew that they were dealing with taxpayer and intended to gratuitously sell him said bonds at less than their face value.

244 11. In failing to give effect in its decision to the opinion rendered by it that taxpayer was entitled to a deduction in each of the taxable years 1939 and 1940 of $750.00 expended in entertaining clients in the course of his business and paying for meals for employees, for which he was not reimbursed by his law firm. Such failure to give effect to said opinion resulted in an additional deficiency against taxpayer for the years 1939 and 1940 of $52.50 and $162.80, respectively.

12. In ordering and deciding that there are deficiencies in income for the years 1939 and 1940 in the amounts of $624.89 and $2,345.47, respectively.

13. In failing to order and decide that there are deficiencies in income tax for the years 1939 and 1940 only in the amounts of $363.75 and $579.45, respectively.

Sidney C. Nierman
Attorney for this Petitioner and Respondent on Review.
33 North LaSalle Street
Chicago, Illinois

245 In the United States Circuit Court of Appeals.

(Caption 4189)

NOTICE OF FILING PETITION FOR REVIEW AND STATEMENT OF POINTS.

Filed Nov. 7, 1946.

To: J. P. Wenchel, Chief Counsel,
Bureau of Internal Revenue.

You are hereby notified that Lewis F. Jacobson did, on the 6th day of Nov., 1946, file with the Clerk of The Tax Court of the United States, at Washington, D. C., a petition for review by the United States Circuit Court of Appeals for the Seventh Circuit, of the decision of this Court heretofore rendered in the above-entitled case. Copies of the petition for review and the statement of points as filed are hereto attached and served upon you.

Dated this 7th day of November, 1946.

A. B. Cypert, *Acting Clerk.*
Victor S. Mersch, *Clerk.*
The Tax Court of the United States

Service of copy of Petition for Review and Statement of Points acknowledged this Nov. 7, 1946.

(Signed) J. P. Wenchel,
Chief Counsel.
Bureau of Internal Revenue,
Attorney for Respondent.

246 IN THE UNITED STATES CIRCUIT COURT OF APPEALS.

(Caption—4189)

JOINT DESIGNATION OF PORTIONS OF RECORD.

Filed Jan. 31, 1947.

To the Clerk of The Tax Court of the United States:

You will please prepare, transmit and deliver to the Clerk of the United States Circuit Court of Appeals for the Seventh Circuit, copies duly certified as correct of the following documents and records in the above-entitled proceedings in connection with the petitions for review by the said Circuit Court of Appeals for the Seventh Circuit, heretofore filed by the Commissioner of Internal Revenue and by the taxpayer, Lewis F. Jacobson.

1. Docket entries of the proceedings.

2. Pleadings:

(a) Petition for redetermination, including annexed copy of deficiency letter and statements attached to petition.

(b) Answer to petition.

3. Opinion of Tax Court promulgated May 10, 1946.

4. Respondent's computations for entry of decision filed June 12, 1946 and August 1, 1946.

247 5. Petitioner's Objection to Respondent's Computation for Entry of Decision and Alternative Computation with Statement of Tax annexed.

6. Decision entered August 7, 1946.

7. Transcript of the Official Report of Proceedings before the Tax Court (omitting lines 23, 24, 25, and 26 of page 73, pages 74 to 79 down to "cross examination", lines 25 and 26 of page 88, 89 and 90, and lines 1, 2, 3, 4, 5, 6, and 7, on page 91).

8. Petitioner's exhibits 1 to 6, both inclusive, and respondent's Exhibits A and B.

9. Petition for review filed by the Commissioner of Internal Revenue, together with proof of service of notice of filing petition for review and of service of a copy of petition for review.

10. Petition for review filed by the taxpayer, Lewis F. Jacobson, together with proof of service of notice of filing petition for review and of service of a copy of petition for review.

11. Statement of Points to be relied upon by the Commissioner.

12. Statement of Points to be relied upon by the taxpayer.

13. Orders enlarging time for the preparation of the evidence and for the transmission and delivery of the record.

14. This Joint Designation.

Said transcript to be prepared, certified and transmitted as required by law and the rules of the Circuit Court of Appeals for the Seventh Circuit.

(s) Sewall Key
Acting Assistant Attorney General.
(s) J. P. Wenchel,
Chief Counsel,
Bureau of Internal Revenue,
Counsel for Commissioner of Internal Revenue.

(Illegible.)
Counsel for the Taxpayer.

CRM has 1 20 47

248 THE TAX COURT OF THE UNITED STATES.

(Caption—4189)

ORDER ENLARGING TIME.

Upon motion of counsel for the Commissioner, and consent of counsel for the taxpayer, it is

Ordered that the time for preparation, transmission and delivery of the record sur petition for review of the above entitled proceeding in the United States Circuit Court of Appeals for the Seventh Circuit is extended to January 29, 1947.

(Signed) Bolon B. Turner
Presiding Judge.

Now, February 26, 1947, the foregoing order is certified from the record as a true copy.

Victor S. Mersch
(Seal) *Clerk*

Dated: Washington, D. C. December 2, 1946.
mhw

249 In the United States Circuit Court of Appeals.

(Caption—4189)

ORDER.

Filed Jan. 22, 1947.

For Cause Shown, It Is Ordered that the time within which to complete, transmit and file the transcript of record on review in the above-entitled causes to this Court, be and the same is extended to and including March 30, 1947.

And It Is Further Ordered that the Clerk of this Court transmit to the Clerk of The Tax Court of the United States a certified copy of this order.

s/ William M. Sparks
U. S. Circuit Judge
January 20, 1947.

Filed this 20th day of January, 1947. A True Copy.
s/ Kenneth J. Carrick,
Teste: *Clerk, United States Circuit Court*
(Seal) *of Appeals for the Seventh Circuit.*
CRM/has 1/7/47

250 The Tax Court of the United States.

(Caption—4189)

CERTIFICATE.

I, Victor S. Mersch, clerk of The Tax Court of the United States do hereby certify that the foregoing pages, 1 to 240, inclusive, contain and are a true copy of the transcript of record, papers, and proceedings on file and of record in my office as called for by the Praecipe in the appeal (or appeals) as above numbered and entitled.

In testimony whereof, I hereunto set my hand and affix the seal of The Tax Court of the United States, at Washington, in the District of Columbia, this 26th day of February, 1947.

Victor S. Mersch,
Clerk.
(Seal) The Tax Court of the United States.
E. M. T.

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT

I, Kenneth J. Carrick, Clerk of the United States Circuit Court of Appeals for the Seventh Circuit, do hereby certify that the foregoing printed pages contain a true copy of the printed transcript of the record filed in this Court on the twenty-third day of July 1947, in Cause No. 9319 and 9320, Commissioner of Internal Revenue, Petitioner, vs. Lewis F. Jacobson, Respondent, No. 9319; Lewis F. Jacobson, Petitioner, vs. Commissioner of Internal Revenue, Respondent, No. 9320; as the same remains upon the files and records of the United States Circuit Court of Appeals for the Seventh Circuit.

In testimony whereof I hereunto subscribe my name and affix the seal of said United States Circuit Court of Appeals for the Seventh Circuit, at the City of Chicago, this thirteenth day of February A. D. 1948.

[SEAL.] (S) KENNETH J. CARRICK,
Clerk of the United States Circuit Court of Appeals for the Seventh Circuit.

Placita.

At a regular term of the United States Circuit Court of Appeals for the Seventh Circuit, held in the City of Chicago, and begun on the first day of October, in the year of our Lord one thousand nine hundred and forty-six, and of our Independence the one hundred and seventy-first.

No. 9319

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

vs.

LEWIS F. JACOBSON, RESPONDENT

No. 9320

LEWIS F. JACOBSON, PETITIONER

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Petitions for Review of Decision of the Tax Court of the United States.

And afterwards, to wit, on the fifth day of December 1947, there was filed in the office of the Clerk of this Court the opinion of the

Court which said opinion is in the words and figures following, to wit:

In the United States Circuit Court of Appeals for the Seventh Circuit

October Term and Session, 1947

No. 9319

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

vs.

LEWIS F. JACOBSON, RESPONDENT

No. 9320

LEWIS F. JACOBSON, PETITIONER

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Petitions for Review of Decision of the Tax Court of the United States

December 5, 1947

Before MAJOR and KERNER, Circuit Judges, and LINDLEY, District Judge

MAJOR, Circuit Judge. These petitions are here to review a decision of the Tax Court of the United States. In No. 9319, the Commissioner requests a review of that part of the decision unfavorable to him, and in No. 9320, Lewis F. Jacobson (taxpayer) requests a review of that part of the decision unfavorable to him. The petitions in each instance have to do with deficiencies in the taxpayer's income taxes for the years 1938, 1939 and 1940.

The principal issues involved are whether the taxpayer realized taxable income within the meaning of Secs. (a) and (b) of the Revenue Act of 1938 and the Internal Revenue Code from his purchase at a discount of his own mortgage bonds originally issued at par, (1) as a result of direct negotiations between the taxpayer and the bondholders, and (2) as a result of negotiations with the bondholders carried out by agents of the taxpayer or with an agent of the bondholders, both parties knowing of the agency.

The Tax Court held that situation (1) above was controlled by Helvering v. American Dental Co., 318 U. S. 322, but that situation (2) was controlled by United States v. Kirby Lumber Co.,

284 U. S. 1. The Commissioner contends that the Kirby Lumber Co. case controls both situations, while the taxpayer urges that the American Dental Co. case is controlling as to both.

A third issue is whether the Tax Court erred in approving the Commissioner's computation under Rule 50 as respects the amounts allowed the taxpayer for entertainment expenses.

On or about May 1, 1925, the taxpayer borrowed the sum of $90,000 from the South Side Trust and Savings Bank of Chicago, Illinois; and he and his wife executed 200 bonds secured by a mortgage trust deed on a building located at the northwest corner of 47th Street and Drexel Boulevard, Chicago, and a leasehold running for 99 years from May 1, 1914, to evidence and secure the payment of the loan. The bonds were payable at the rate of $2,500 semiannually, to and including November 1, 1931, and the balance of $57,500 on May 1, 1932, with interest at 6 per cent per annum. All the bonds which became due up to and including November 1, 1931, were paid at or about their respective maturity dates.

The South Side Trust and Savings Bank closed on June 8, 1931; and a bondholders' committee was formed for the bondholders who had purchased bonds on taxpayer's building. On May 1, 1932, the taxpayer, after communicating with the individual bondholders as well as the bondholders' committee, procured an extension to May 1, 1937, for payment of the principal of the bonds.

During the extended period checks for interest were issued by taxpayer directly to the holders of the bonds, which were delivered to them by R. W. Gerding, secretary of the committee. Bondholders frequently visited the taxpayer at his office in connection with the collection of their interest and to ascertain the financial status of the debtor. The taxpayer kept a list of the bondholders, the dates of the payment of their interest, the numbers of their bonds and their addresses, and was fully informed as to who owned the bonds as well as their whereabouts, and they were kept informed from time to time as to taxpayer's general financial condition.

In 1937, the taxpayer paid 10% on account of the principal of the bonds then outstanding and again procured an extension of time for the payment of the remaining bonds to 1942.

As of January 1, 1938, the principal amount of the bonds unpaid was $51,750.00. The Tax Court found that the taxpayer was solvent during each of the taxable years 1938, 1939, and 1940, and we accept the finding, although a perusal of the record makes it quite apparent that he was in straitened financial circumstances. The Tax Court having thus found, we see no occasion to relate the somewhat lengthy and complicated facts concerning the value of the building which secured the bonds, its depreciation, the rental

income derived therefrom, or the extent of the taxpayer's income from other sources.

The taxpayer is a lawyer and during the taxable years was a member of the firm of Jacobson, Nierman & Silbert, attorneys at law. Commencing in 1938 and continuing through the years 1939 and 1940, the taxpayer purchased certain of his outstanding bonds either directly from the bondholders or through his agent or an agent of the bondholders at amounts less than their face value. The difference between the face amount of such bonds and the amount at which they were purchased was included by the Commissioner as a part of the taxpayer's gross income, and it was this action of the Commissioner which formed the main subject of controversy before the Tax Court.

The Tax Court made detailed findings as to the dates, amounts and other circumstances concerning each bond purchased. The Commissioner has, in the main repeated such findings in his brief. For the purpose of this opinion, we are of the view that a brief resume of such facts is sufficient. During the year 1938, purchases were made from three bondholders, the face value of which was $4,950.00, for the sum of $2,227.50, or a difference of $2,722.50. The purchase made on April 9, 1938, from Beatrice Adamson and Margaret Finn is typical of the other two purchases. The checks of Sidney C. Nierman (a partner of the taxpayer whose office was the same as the taxpayer's) were issued to the owners of the bonds, with an endorsement that they were in full payment of the purchase price of the bonds. The taxpayer reimbursed Nierman for this payment, as Nierman was acting for him in the transaction and the owners of the bonds knew that he was.

Three purchases were made in 1939 one on June 16, wherein the taxpayer paid directly $225.00 for bonds having a face value of $450.00. On February 15, 1939, the taxpayer purchased bonds of the face value of $1,800.00, owned by one Samuels, through McGraw & Company, for the sum of $900.00. On October 23, 1939, taxpayer purchased bonds of a face value of $180.00, owned by one Zentner, through the firm of Anderson, Plotz & Company, for the amount of $86.50, and paid the firm a fee of $10.00 for making the purchase. In 1940, the taxpayer made eight purchases of bonds at less than their face value, four of which were through R. W. Gerding, secretary of the bondholders' committee, for which he paid the latter a fee in each instance, ranging from $7.50 to $27.00. Four other purchases in this year were made, all at less than their face value, through Anderson, Plotz & Company, and in each a fee was paid, ranging from $1.50 to $25.00. The total face value of the bonds thus purchased in 1940 by the taxpayer was the sum of $7,020.00, and the amount paid by the taxpayer was the sum of $2,950.00, or a difference of $4,070.00.

The Tax Court found: "There was never any listing of the bonds or quoted price. Nobody was buying these bonds except petitioner."

Inasmuch as the Tax Court differentiates between the bonds purchased by the taxpayer directly from the owners thereof and those purchased by the taxpayer through an agent, either of his or the bondholder, it appears pertinent to note the circumstances connected with these so-called agency purchases. R. W. Gerding, who acted as the agent of the taxpayer as to the purchase of certain bonds, was instructed by the taxpayer as to the price he was willing to pay. Each of the bondholders knew that the bonds were being sold to the taxpayer. They knew where Gerding's office was located and knew that he was in at all times, while the taxpayer was out of his office much of the time. When they dealt with Gerding they did so with knowledge that he was the agent of the taxpayer. When a bond was purchased by Gerding, the taxpayer was notified, his check was issued to the holder from whom the bond was being purchased and delivered to Gerding.

There was only one purchase through McGraw & Company, which was a bond owned by H. N. Samuels. Samuels had first contacted the taxpayer, requesting payment on his bond. Subsequently the taxpayer was approached by McGraw & Company, acting for Samuels, and the taxpayer agreed to purchase the bond. Samuels knew that his bond was being sold to the taxpayer.

Arthur Green, a member of the brokerage firm of Anderson, Plotz & Company, was a close personal friend of the taxpayer. For the reason that he was busily occupied otherwise, taxpayer requested Green to assist him in purchasing certain bonds. Green was furnished by the taxpayer with a list of bondholders and he subsequently made a number of purchases. All of such bondholders had previously talked to the taxpayer and some had been told by him to see Green, who was acting as his agent. Again there is no question but that all the bondholders knew that Green was acting as agent of the taxpayer, that the bonds were being sold to the taxpayer and that the purchase price agreed upon was to be paid by the taxpayer.

As already noted, a decision as to whether the taxpayer realized a taxable gain by the purchase of bonds representing his personal indebtedness at less than their face value is dependent upon whether the situation is controlled by United States v. Kirby Lumber Co., supra, as argued by the Commissioner, or by Helvering v. American Dental Co., supra, as argued by the taxpayer. So much has been said and written concerning these two decisions of the Supreme Court, we realize our inability to elucidate further. In short, the only real distinction we are able to draw between these two cases is that in the Kirby case bonds representing the

indebtedness were purchased by the debtor in the open market, while in the American Dental Company case notes with accrued interest and an open account representing the indebtedness were settled at a discount by the debtor dealing with his creditors. That the Kirby case is to be distinguished from the fact that the bonds were purchased in the open market is indicated in Helvering v. American Chicle Co., 291 U. S. 426. There, the Board of Tax Appeals, affirmed by the Court of Appeals, had denied the Commissioner's contention that corporate bonds purchased at less than their face value represented a gain to the taxpayer. The Supreme Court held otherwise under the authority of the Kirby case, and in so doing stated (page 430): "During 1922, 1924, and 1925 it purchased a considerable number of these bonds in the market at less than their face."

In the Kirby case there were, of course, no negotiations between the debtor and its bondholders. Both treated the bonds merely as property to be sold or purchased on the open market. The bondholders could not have had any idea that they were selling to the debtor and thus forgiving part of their claim. The court did not consider the question of gratuitous cancellation of indebtedness and there was no occasion for it to do so, for the reason that the bondholder, selling his bond on the open market, could not have intended to cancel any claim against the debtor. As far as the bondholder was concerned or had knowledge, the claim remained outstanding in the hands of a new owner.

On the other hand, in the American Dental Company case the court was concerned with a situation where the debtor dealt directly with its creditors in settling its debts for less than their face value. Concerning this character of settlement, the court stated (page 330):

"The release of interest or the complete satisfaction of an indebtedness by partial payment by the voluntary act of the creditor is more akin to a reduction of sale price than to financial betterment through the purchase by a debtor of its bonds in an arm's-length transaction. * * * The fact that the motives leading to the cancellations were those of business or even selfish, if it be true, is not significant. The forgiveness was gratuitous, a release of something to the debtor for nothing, and sufficient to make the cancellation here gifts within the statute."

The Court of Claims in Campan Realty Co. v. United States, 69 F. Supp. 133, referring to the American Dental Co. case, stated (p. 134):

"In that case the court differentiated between a purchase of its bonds by a corporation on the open market and the purchase of them from the bondholders direct. In the latter case the Supreme Court held that the forgiveness of any part of a debt by a bondholder, without any consideration to him, was, of course, gratuitous

and, therefore, a gift within the meaning of the statute, whether or not the motives leading to the forgiveness were of a business nature or selfish."

We have examined numerous cases cited and relied upon by the Commissioner which we find no reason for discussing. Some of them were decided prior to the American Dental Company case and others have no bearing upon a state of facts such as is here presented.

As to the bonds purchased by the taxpayer directly from the bondholders, including those purchased by the taxpayer's law partner, Nierman, we are of the view that such purchases come squarely within the rationale of the American Dental Company case and that the difference between the face value of such bonds and the purchase price paid by the taxpayer does not represent taxable gain. To this extent we agree with the Tax Court.

We are of the view, however, that the Tax Court erred in its holding that the difference in the face value and the purchase price of the other bonds, that is, those purchased by the taxpayer either through his agent or an agent of the bondholder, represented taxable gain. As to this class of bonds, the Tax Court stated:

"It is petitioner's contention in the instant case that there was no open market for the sale of his bonds. It is true that there was no open market for the bonds in the sense that they were bought and sold on any securities exchange or in an over-the-counter market. However, the manner by which petitioner acquired a number of his bonds * * * is close akin to purchase in the open market, if indeed it does not properly fall within that sort of classification. As to these purchases the personal element we think necessary to make a gift within the meaning of the American Dental Co. case was absent."

We find ourselves in disagreement with this reasoning. In the first place, the fact that these bonds were purchased through an agent either of the taxpayer or the owner does not characterize them as open market transactions, if we understand the meaning of that term. As the Tax Court found, none of these bonds were listed or had a quoted price and nobody was buying them except the taxpayer, and we regard as immaterial under the circumstances heretofore related the fact that two of the agents employed were members of brokerage firms. Neither do we think that the personal relation of the parties was the important and certainly it was not the controlling element of the American Dental Company case. As we have shown, the important and we think controlling feature of that case is that the debtor was dealing with its creditors in such a manner that they parted with their security at less than its face value with knowledge that the amount received was in discharge of the debtor's obligation.

We also are of the view that it is of no consequence in the instant case that the taxpayer as to the purchase of some bonds dealt with his creditors through an agent rather than in a face to face transaction. These transactions are nevertheless direct in the sense that the taxpayer settled his debt with the person to whom it was owed, and, conversely, the creditor made settlement with his debtor and knowingly received from the latter the debtor's check in discharge of the debt. In contrast, if the taxpayer had purchased his bonds on the open market he in all probability would not have known who was the owner, and neither would the creditor, if his bond had been sold on the open market, have known whether its purchase was for the taxpayer or a stranger.

It seems to us that a differentiation between the situation where the debtor purchases his bond from a creditor in a face to face transaction and one where the debtor accomplishes the same purpose through an agent is a refinement too nebulous to be practical. What difference does it make whether the debtor performs the actual service himself or through his lawyer or the secretary of a bondholders' committee? In any event, the objective sought and the result accomplished is the same. And what difference can it make whether his creditor is a relative, an intimate friend, a casual acquaintance or even a stranger, providing such creditor when a settlement is made knows that it is being done with his debtor and that the debt is being paid for less than its face value and the remainder cancelled? In one instance as much as the other the cancellation amounts to a gratuitous forgiveness and a release of something to the debtor for nothing. To think otherwise is to embrace the form and ignore the substance. As was said in Bowers, Collector v. Kerbaugh-Empire Co., 271 U. S. 170, 174, "In determining what constitutes income substance rather than form is to be given controlling weight."

Lastly, the taxpayer contends that the Commissioner erroneously computed his deficiencies for the years 1939 and 1940 by failing to give him credit for the proper amount of entertainment expenses, in accordance with the decision of the Tax Court. While the record is somewhat confusing, it discloses the following situation. We shall refer to the year 1940, and the same situation exists as to the year 1939, with some variation in the figures.

The taxpayer originally claimed as deductible items on account of entertainment expense the amount of $2,261.54. The taxpayer substantiated this amount by documentary proof except $750.00, which is referred to as the nonrecorded items or out-of-pocket expense. Of this $750.00 the Commissioner allowed $350.00 and disallowed $400.00. The Commissioner, therefore, allowed the taxpayer the total amount of $1,861.54 ($2,261.54 minus $400.00).

The issue presented to the Tax Court on this phase of the case, as shown by the taxpayer's petition and the statement of counsel

for the Commissioner made at the commencement of the hearing before the Tax Court, was the alleged error of the Commissioner in disallowing automobile and entertainment of expenses for the year 1940 in the amount of $750.55. This amount included the $400.00 disallowed by the Commissioner as entertainment expense, and $350.55 disallowed by the Commissioner as automobile expense.[1]

Thus, the sole issue before the Tax Court relative to personal entertainment expense was the $750.00 unrecorded item, and of this amount only $400.00 had been disallowed by the Commissioner. The amount of $1,864.54 previously allowed by the Commissioner was in no way involved in the proceeding before the Tax Court. That court found: "Petitioner expended at least $750.00 in each of the taxable years 1939 and 1940 in the entertainment of employees and clients and was not reimbursed therefor by the firm or by the clients. He kept no itemized account of these expenses." In its opinion the Tax Court refers to the taxpayer's testimony, which showed that he expended a much larger amount of which he had no record in each of these years, and stated: "However, he has testified at length about them and how and under what circumstances he made them and we are convinced that he expended at least $750.00 for these purposes and we have so found in our findings of fact." The Tax Court continues: "In a computation under Rule 50 the Commissioner should allow petitioner a deduction of a total of $750.00 in each of the taxable years 1939 and 1940 for these entertainment expenses." It is perfectly obvious, so we think, that what the Tax Court referred to both in its findings and opinion were the unrecorded items of expense claimed by the taxpayer. That must be so for there was no other issue before it. More specifically, what the Tax Court held was that the Commissioner had erroneously disallowed $400.00 of this item ($350.00 had been allowed by the Commissioner).

Now what did the Commissioner do in computing the taxpayer's deficiencies? On June 12, 1946, he filed a computation in which he allowed the taxpayer only $750.00 for entertainment expense in lieu of the $1,864.54 which had been originally allowed. In other words, after the taxpayer had won his point before the Tax Court he was allowed for entertainment expense $1,114.54 less than the amount the Commissioner had originally allowed him ($1,864.54 minus $750.00).

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[1] The taxpayer showed an automobile expense of $1,051.66, and claimed that two-thirds of such amount, or $701.10, was expended in connection with his business. The Commissioner allowed one-third of such automobile expense, or $350.55, and disallowed one-third, or the same amount. It was this one-third disallowed by the Commissioner which was included in the $750.55 item of which the taxpayer complained before the Tax Court. That court allowed the taxpayer one-half of his automobile expense, or $525.83, which amount has been allowed in the Commissioner's final computation. It is, therefore, no longer in dispute and need not be again referred to.

The taxpayer filed objections to the Commissioner's computation and on August 1, 1946, the Commissioner filed a revised computation in which he allowed as entertainment expense the amount of $1,864.54. This was the exact amount which the Commissioner had originally allowed, and failed to take into account the additional $400.00, which the Tax Court held the Commissioner had erroneously disallowed. In other words, on this revised computation the taxpayer, after winning his point in the Tax Court, was relegated to the precise situation which he originally occupied. He had neither won nor lost by the decision of the Tax Court. It is, therefore, our opinion that he was entitled in the computation to an allowance of $2,264.54 for entertainment expenses for the year 1940 ($1,864.54 previously allowed by the Commissioner, plus $400.00 held by the Tax Court to have been erroneously disallowed by the Commissioner). On the same basis, his allowance for entertainment expenses for the year 1939 should be increased in the amount of $450.00.

The decision of the Tax Court is, therefore, in part affirmed and in part reversed and remanded, with directions to proceed in accordance with the views herein expressed.

A true Copy.

Teste:

_____

Clerk of the United States Circuit Court of Appeals for the Seventh Circuit.

And on the same day, to wit, on the fifth day of December 1947, the following further proceedings were had and entered of record, to wit:

United States Circuit Court of Appeals for the Seventh Circuit

Friday, December 5, 1947

Before Hon. J. Earl Major, Circuit Judge; Hon. Otto Kerner, Circuit Judge; Hon. Walter C. Lindley, District Judge

No. 9319

Commissioner of Internal Revenue, petitioner

vs.

Lewis F. Jacobson, respondent

Petition for Review of an order of the Tax Court of the United States

This cause came on to be heard on the transcript of the record from the Tax Court of the United States, and was argued by counsel:

On consideration whereof: it is ordered and adjudged by this Court that the decision of the Tax Court of the United States entered in this cause on August 7, 1946, be, and the same is hereby, affirmed in part and reversed in part, and that this cause be, and the same is hereby remanded to the Tax Court of the United States with directions to proceed in accordance with the views expressed in the opinion of the Court filed this day.

United States Circuit Court of Appeals for the Seventh Circuit

Friday, December 5, 1947

Before Hon. J. Earl Major, Circuit Judge; Hon. Otto Kerner, Circuit Judge; Hon. Walter C. Lindley, Circuit Judge

No. 9320

Lewis F. Jacobson, petitioner

vs.

Commissioner of Internal Revenue, respondent

Petition for Review of an order of the Tax Court of the United States

This cause came on to be heard on the transcript of the record from the Tax Court of the United States, and was argued by counsel.

On consideration whereof, it is ordered and adjudged by this Court that the decision of the Tax Court of the United States entered in this cause on August 7, 1946, be, and the same is hereby, affirmed in part and reversed in part, and that this cause be, and the same is hereby, remanded to the Tax Court of the United States with directions to proceed in accordance with the views expressed in the opinion of this Court filed this day.

United States Circuit Court of Appeals for the Seventh Circuit

I, Kenneth J. Carrick, Clerk of the United States Circuit Court of Appeals for the Seventh Circuit, do hereby certify that the foregoing typewritten pages contain a true copy of the opinion of the Court filed December 5, 1947; and the Judgment of the Court entered December 5, 1947, in Cause No. 9319 and 20, Commissioner of Internal Revenue, Petitioner, vs. Lewis F. Jacobson, Respondent, No. 9319; Lewis F. Jacobson, Petitioner, vs. Commissioner of Internal Revenue, Respondent, No. 9320; as the same remains upon the files and records of the United States Circuit Court of Appeals for the Seventh Circuit.

In testimony whereof I hereunto subscribe my name and affix the seal of said United States Circuit Court of Appeals for the Seventh Circuit, at the City of Chicago, this thirteenth day of February A. D. 1918.

[SEAL] (S) KENNETH J. CARRICK.
Clerk of the United States Circuit Court of Appeals for the Seventh Circuit.

Supreme Court of the United States

No. 32, October Term, 1948

Order allowing certiorari.

Filed April 5, 1948

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Seventh Circuit is granted, and the case is transferred to the summary docket.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

Supreme Court of the United States

No. 33. October Term, 1948

Order allowing certiorari

Filed April 5, 1948

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Seventh Circuit is granted, and the case is transferred to the summary docket.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

796662—48——3

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In the Supreme Court of the United States

OCTOBER TERM, 1947

No. —

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

LEWIS F. JACOBSON

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT

The Solicitor General, on behalf of the Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the Circuit Court of Appeals for the Seventh Circuit entered in the above-entitled cause on December 5, 1947.

OPINIONS BELOW

The opinion of the Tax Court (R. 120–135) is reported in 6 T. C. 1048. The opinion of the Circuit Court of Appeals (R. 166–174) is reported in 164 F. 2d 594.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on December 5, 1947. (R. 174–175.) The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the taxpayer, who was solvent during the taxable years, realized income, within the meaning of the applicable tax statutes and regulations, when he purchased his own bonds at less than their face value.

STATUTES AND REGULATIONS INVOLVED

Revenue Act of 1938, c. 289, 52 Stat. 447:

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

(b) *Exclusions from Gross Income.*—The following items shall not be included in gross income and shall be exempt from taxation under this title:

* * * * *

(3) *Gifts, bequests, and devises.*—The value of property acquired by gift, bequest, devise, or inheritance (but the income from such property shall be included in gross income);

* * * * *

Section 22 (a) and (b) (3) of the Internal Revenue Code (26 U. S. C. 22) is identical with the above provisions.

Treasury Regulations 101, promulgated under the Revenue Act of 1938:

> ART. 22 (a)–14. *Cancellation of indebtedness.*—(a) *In general.*—The cancellation of indebtedness, in whole or in part, may result in the realization of income. If, for example, an individual performs services for a creditor, who in consideration thereof cancels the debt, income in the amount of the debt is realized by the debtor as compensation for his services. A taxpayer realizes income by the payment or purchase of his obligations at less than their face value. (See article 22 (a)–18.) * * *.

Section 19.22 (a)–14 of Treasury Regulations 103, promulgated under the Internal Revenue Code, is identical with the above provisions.

STATEMENT

The facts as found by the Tax Court relating to the purchase by the taxpayer of his own bonds (R. 122–128) may be summarized as follows:

The taxpayer is an individual, residing in Chicago, Illinois, where he filed his income tax returns. (R. 122.) The taxable years are 1938, 1939 and 1940. (R. 121.)

In May 1925, the taxpayer borrowed $90,000 from the South Side Trust and Savings Bank, and he and his wife executed 200 bonds secured by a mortgage trust deed on certain real estate

in Illinois to evidence the loan. The proceeds of the loan were used to pay off the existing encumbrance on the property, to pay for an addition to the building which cost $16,250, and to pay the necessary brokerage commissions and expenses in connection with the loan, leaving a small surplus over and above these items which was paid to the taxpayer. (R. 122–123.)

The bonds were payable at the rate of $2,500 semiannually to and including November 1, 1931, and the balance of $57,500 on May 1, 1932, with interest at 6½% per annum. All of the bonds which became due up to and including November 1, 1931, were paid at or about their respective maturity dates. On June 8, 1931, the South Side Trust and Savings Bank failed to open its doors. (R. 123.)

A bondholders' committee was formed for the bondholders who had purchased bonds on the taxpayer's building. On May 1, 1932, the taxpayer applied to the bondholders' committee and the bondholders themselves for an extension of time for the payment of this loan; and procured an extension to May 1, 1937, for the payment of the principal of the bonds. At no time did the taxpayer default in the payment of interest on the bonds. During this extended period checks for interest were issued by the taxpayer directly to the holders of the bonds and were delivered to them by the secretary of the committee. (R. 123.)

In 1937 the taxpayer again procured an extension of time for the payment of the bonds to 1942, and in that connection paid 10% on account of the principal of the bonds, leaving an unpaid balance as of January 1, 1938, of $51,750. (R. 123.)

In 1938, 1939, and 1940, the taxpayer purchased certain of his bonds for amounts less than their face value. Some of the purchases were directly from the holders, and some were through brokerage firms or through the bondholders' committee. (R. 123–126).[1] There was never any listing of the

[1] The following table shows the dates of purchase, method of purchase, face value and purchase price of the taxpayer's bonds which he bought during the taxable years:

Date of purchase	D—Direct, B—broker, C—Bondholders' committee	Face value	Purchase price	Percentage of face amount paid by taxpayer
1938				
Apr. 9, 1938 (R. 124-125)	D	$450	$202.50	45
June 9, 1938 (R. 124)	D	3,600	1,620.00	45
Aug. 17, 1938 (R. 124)	D	900	405.00	45
1938	D	900	957.00	+100
1939				
Feb. 15, 1939 (R. 124)	B	1,800	900.00	50
June 16, 1939 (R. 124)	D	450	225.00	50
Oct. 26, 1939 (R. 124)	B	180	86.50	48
1940				
Apr. 4, 1940 (R. 125)	C	270	130.00	48
May 21, 1940 (R. 125)	C	450	210.00	47
May 24, 1940 (R. 125)	C	2,700	1,080.00	40
June 19, 1940 (R. 125)	C	1,800	720.00	40
July 1, 1940 (R. 125)	B	450	185.00	41
July 3, 1940 (R. 125)	B	450	175.00	39
July 10, 1940 (R. 125)	B	450	184.50	41
Sept. 23, 1940 (R. 125)	B	450	185.00	41
Total		15,000	7,265.50	

[2] Approximate figure.

[3] Net.

bonds or a quoted price. Nobody was buying these bonds except the taxpayer. (R. 126.)

At all times during the years 1938, 1939 and 1940, the value of the property securing the bonds exceeded the bonded indebtedness. (R. 126.) The taxpayer owned considerable other property in Chicago outside of the property which secured the bonds (R. 127), and had gross income from other sources in excess of $35,000 in each of those years (R. 126). The taxpayer was solvent during each of the taxable years 1938, 1939 and 1940. (R. 127.)

The Tax Court distinguished between the bonds purchased directly from the holders and the bonds purchased through brokers and the bondholders' committee. With respect to the bonds purchased through brokers and the bondholders' committee, the Tax Court held that the difference between the issuance price and the purchase price constituted taxable income under *United States* v. *Kirby Lumber Co.*, 284 U. S. 1. With respect to the bonds purchased through direct negotiations with the bondholders, it held that the difference between the purchase price and the issuance price represented gifts under *Helvering* v. *Amer. Dental Co.*, 318 U. S. 322. Five of the six dissenting judges of the Tax Court expressed the view that the *Kirby Lumber* case governed all the transactions here in question. (R. 132–135.) On cross-appeals to the court below, it was held that the *American Dental* case governed all of the

transactions and hence that no income was realized by the taxpayer from any of the purchases. (R. 171.)

SPECIFICATION OF ERRORS TO BE URGED

The court below erred:

1. In deciding that where the taxpayer purchased his own bonds at less than their face value, the taxpayer did not realize income within the meaning of Section 22 (a) of the Revenue Act of 1938 and of the Internal Revenue Code and the applicable Treasury Regulations.

2. In failing to decide that where the taxpayer purchased his own bonds at less than their face value, he realized income within the meaning of Section 22 (a) of the Revenue Act of 1938 and of the Internal Revenue Code and the applicable Treasury Regulations, regardless of whether he purchased them by direct negotiations with the holders or through a broker or other intermediary.

3. In reversing that part of the decision of the Tax Court which held that where the taxpayer purchased his own bonds at less than their face value through a broker or other intermediary, he realized income within the meaning of Section 22 (a) of the Revenue Act of 1938 and of the Internal Revenue Code and the applicable Treasury Regulations.

REASONS FOR GRANTING THE WRIT

1. The decisions of the Tax Court and of the court below in this case reflect a general confusion

that exists in regard to the proper interpretation of two decisions of this Court, *United States* v. *Kirby Lumber Co.*, 284 U. S. 1, and *Helvering* v. *Amer. Dental Co.*, 318 U. S. 322, with particular reference to the extent to which the later case implicitly qualified or limited the principle expressed in the *Kirby Lumber* case. In the latter case this Court held that where a corporate taxpayer purchased its own bonds at a discount, the difference between the purchase price and the face value constituted income. This conclusion was supported on two grounds: (1) the Treasury regulations so provided, and they should not be rejected as an erroneous statement of the law; and (2) the transaction made available to the taxpayer assets previously offset by the obligation of bonds now extinct. In the *American Dental* case, this Court held that the forgiveness of back rent and the cancellation of interest on notes did not constitute income to the debtor, but represented a gift within the meaning of Section 22 (b) (3) of the Rev. Act of 1936, c. 690, 49 Stat. 1648, regardless of donative intent on the part of the creditor. The *Kirby Lumber* case was neither overruled nor qualified in any way.

The inability of the Tax Court and the lower courts to effect a satisfactory reconciliation of these decisions is graphically evidenced by the three different rulings made by the various judges who considered this case below: (1) The *American Dental* case controls all of the transactions in which the taxpayer purchased his

own bonds for less than their face value, as held by the court below. (2) The *Kirby Lumber* case controls all of the transactions, as held by the dissenting judges of the Tax Court. (3) Some of the transactions are controlled by the *American Dental* case and others by the *Kirby Lumber* case, depending upon whether the taxpayer had direct negotiations with the bondholders, as held by the majority of the Tax Court.

2. Other courts have reached results that indicate conflicting interpretations of the *American Dental* case, as applied to the purchase of bonds or other evidence of indebtedness at less than face value.[2] A number of law review articles and one of the leading text books on federal income taxation refer to the difficulty of reconciling the *American Dental* case with the *Kirby Lumber* rule.[3]

The decision of the court below appears to be in conflict with the decision of the Circuit Court of

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[2] *Shellabarger Grain Products Co.* v. *Commissioner*, 146 F. 2d 177, 185 (C. C. A. 7th); *A. M. Carupau Realty Co.* v. *United States*, 69 F. Supp. 133 (C. Cls.); *Central Paper Co.* v. *Commissioner*, 158 F. 2d 131 (C. C. A. 6th); *Fifth Ave. Fourteenth St. Corp.* v. *Commissioner*, 147 F. 2d 453 (C. C. A. 2d).

[3] Plumb, *The Tax Benefit Rule Today*, 57 Harv. L. Rev. 129, 141, fn. 53 (1943); Lynch, *Some Tax Effects of Cancellation of Indebtedness*, 13 Fordham L. Rev. 145, 157–168 (1944); Eisenstein, *Some Iconoclastic Reflections on Tax Administration*, 58 Harv. L. Rev. 477, 516 (1945); 12 Fordham L. Rev. 198 (1943); 11 Geo. Wash. L. Rev. 537 (1943); 44 Columbia L. Rev. 102 (1944); 2 Mertens, Law of Federal Income Taxation, 1947 Cumulative Pocket Supp., Sec. 11.19, pp. 37–38.

Appeals for the Sixth Circuit in *Central Paper Co.* v. *Commissioner*, 158 F. 2d 131 and with the decision of the Circuit Court of Appeals for the Second Circuit in *Fifth Ave.-Fourteenth St. Corp.* v. *Com.*, 147 F. 2d 453. In the *Central Paper Co.* case, the taxpayer purchased from the certificate holders, at prices below par, trustee's certificates, which had been issued in lieu of outstanding bonds of its predecessor, liability for which was assumed by the taxpayer. The Commissioner determined that the difference between the purchase price and the face value constituted income under the rule of the *Kirby Lumber* case. Both the Tax Court and the Sixth Circuit upheld the Commissioner. The latter court distinguished the *American Dental* case on the ground that the certificate holder had made a bona fide sale in the open market due to the latter's preference to receive cash immediately in a reduced amount rather than to receive preferred stock or to wait for the liquidation of the trust. Since the taxpayer bought the certificates from the holder, the result seems to be in conflict with the decision of the court below. The intervention of the trustee between the taxpayer and the certificate holder would seem to be unimportant because the trustee played no substantial part in the transaction.

In the *Fifth Ave.-Fourteenth St.* case, the taxpayer purchased mortgage certificates issued by taxpayer's mortgagee, for less than their face value and the mortgagee accepted the certificates at face

value in reduction of the taxpayer's indebtedness. The Commissioner determined that the amounts by which the face value of the certificates exceeded the taxpayer's cost constituted taxable income under the *Kirby Lumber* rule. Both the Tax Court and the Circuit Court of Appeals upheld the Commissioner; however, the latter court made its conclusion depend upon the solvency of the taxpayer, and remanded the case to the Tax Court to determine whether the taxpayer was solvent during the taxable years. Since the taxpayer was solvent in the present case, the decision of the court below appears also to be in conflict with the decision of the Second Circuit in the *Fifth Ave.-Fourteenth St.* case.

3. The decision of the court below appears to be wrong because the facts of this case resemble those of the *Kirby Lumber* case more closely than those of the *American Dental* case. In the *Kirby Lumber* case a corporation purchased its own bonds at a discount; in the present case an *individual* purchased his own bonds at a discount. If the corporation in the *Kirby Lumber* case realized income as this Court held, it follows that the individual in this case also realized income. The Treasury Regulations indicate that an individual, as well as a corporation, realizes income under such circumstances. See Treasury Regulations 101, Art. 22 (a)–14, and Treasury Regulations 103, Sec. 19.22 (a)–14, *supra*. The taxpayer was solvent during the taxable years (R. 127) and

by virtue of his purchase of his own bonds at a discount, his net assets were increased just as the corporate taxpayer's net assets were increased by similar transactions in the *Kirby Lumber* case.

The court below took the view that the only distinction between the *American Dental* case and the *Kirby Lumber* case is that in the former the purchases were not made "in the open market" (R. 169–170,) while in the latter they were so made. But we do not believe that the distinction made by the court below is valid. In this Court's opinion in the *American Dental* case, reference is apparently made (p. 330) to the transactions in the *Kirby Lumber* case as "arm's-length". If "arm's-length" is the correct test, the transactions in this case would come within the *Kirby Lumber* rule because there is no evidence in the record to show that both parties were not trying to make the best possible bargain. The transactions in this case were not deals between insiders; rather were they deals in which the taxpayer unquestionably bargained at "arm's-length" with the bondholders. One bondholder got more than 100 cents on the dollar (R. 124), and the holders of about 70% of the principal amount of outstanding bonds refused to sell their bonds to the taxpayer (see fn. 1, *supra*, p. 5, and compare with $51,750 face value of bonds outstanding, R. 123).

4. In several instances Congress has exempted from tax income attributable to the discharge of

indebtedness.[4] Where it has done so, it has required certain adjustments in regard to basis in order clearly to reflect income. In the absence of an express statutory exemption none should be implied. *Bank of Commerce* v. *Tennessee*, 161 U. S. 134, 146; *Hale* v. *State Board*, 302 U. S. 95, 103; *Pacific Co.* v. *Johnson*, 285 U. S. 480, 491; *United States* v. *Stewart*, 311 U. S. 60, 71.

The holding of the court below that the difference between the face value and the price paid by the taxpayer for his bonds constitutes a gift within the meaning of Section 22 (b) (3) of the Internal Revenue Code, *supra*, because the bondholders knew that the taxpayer was buying the bonds, is untenable. The mere fact the seller deals directly with the purchaser or his agent does not support the conclusion that the seller did not attempt to get as high a price as possible or that the transaction was not at arm's-length. There is no evidence in the record to show that the bondholders did not seek to get the highest possible price from the taxpayer, which of course precludes the possibility of a gift. Therefore there is no factual basis in this case for a holding that the bondholders made gifts to the taxpayer of the

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[4] Internal Revenue Code, Sec. 22 (b) (9) and (10), as added by Sec. 215 (a) of the Revenue Act of 1939, c. 247, 53 Stat. 862, and Sec. 114 (b) of the Revenue Act of 1942, c. 619, 56 Stat. 798, respectively (26 U. S. C. 22); Bankruptcy Act of July 1, 1898, c. 541, 30 Stat. 544, Secs. 68–70, as amended by the Chandler Act of June 22, 1938, c. 575, 52 Stat. 840, Sec. 1, and by the Act of July 1, 1940, c. 500, 54 Stat. 709, Sec. 1 (11 U. S. C. 668–670).

difference between the face amount of the bonds and the selling price.

5. The case is of general importance because the same question may arise in any case where a taxpayer has bonds outstanding. According to the decision of the court below, in every case where a debtor purchases his or its own bonds at a discount and the seller (bondholder) knows that the debtor is buying the bonds, the difference between the face value and the purchase price constitutes a gift and not income, regardless of any donative intent on the part of the bondholder. There are a number of cases involving the same question pending in the Tax Court and in the lower federal courts.[5] In a decision rendered since that of the court below, the Tax Court has refused to follow the rule laid down by the court below on the ground that it would constitute an unwarranted extension of the *American Dental* rule.[6]

CONCLUSION

In order to resolve the conflict and confusion that generally prevail with regard to the proper scope of the *Kirby Lumber* and *American Dental* decisions, this petition for a writ of certiorari should be granted. The decision of the court below is wrong,

[6] *Edmont Hotel Co.* v. *Commissioner*, 10 T. C. No. 31, promulgated Feb. 10, 1948.

[5] The Bureau of Internal Revenue advises that there are over 40 similar cases in various stages of litigation or controversy, involving about $3,000,000 in income taxes.

and the question involved is of general importance.

Respectfully submitted.

PHILIP B. PERLMAN,
Solicitor General.

MARCH 1948.

U. S. GOVERNMENT PRINTING OFFICE: 1948

Nos. 32 and 33

In the Supreme Court of the United States

OCTOBER TERM, 1948

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

LEWIS F. JACOBSON

ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE PETITIONER

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JURISDICTION

The judgments of the Court of Appeals were entered on December 5, 1947. (R. 174–175.) The petition for writs of certiorari was filed on March 5, 1948, and granted on April 5, 1948. (R. 177.) The jurisdiction of this Court is conferred by 28 U. S. C., Sec. 1254.

QUESTION PRESENTED

Whether the taxpayer, who was solvent during the taxable years, realized income, within the meaning of Section 22 (a) of the Revenue Act of 1938 and the Internal Revenue Code and of the applicable Treasury Regulations, when he purchased his own bonds prior to maturity at less than their face value.

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In 1937 the taxpayer again procured an extension of time for the payment of the bonds to 1942, and in that connection paid 10% on account of the principal of the bonds, leaving an unpaid balance as of January 1, 1938, of $51,750. (R. 123.)

In 1938, 1939, and 1940, the taxpayer purchased certain of his bonds for amounts less than their face value. Some of the purchases were directly from the holders, and some were through brokerage firms or through the bondholders' committee. (R. 123–126.)[1] There was never any listing of the bonds or a quoted price. Nobody was buying these bonds except the taxpayer. (R. 126.)

At all times during the years 1938, 1939 and 1940, the value of the property securing the bonds exceeded the bonded indebtedness. (R. 126.) The taxpayer owned considerable other property in Chicago besides the property which secured the bonds (R. 127), and had gross income from other sources in excess of $35,000 in each of those years (R. 126). The taxpayer was solvent during each of the taxable years 1938, 1939, and 1940. (R. 127.)

[1] The following table shows the dates of purchase, method of purchase, face value and purchase price of the taxpayer's bonds which he bought during the taxable years:

Footnote 1 continued on p. 6.

The Tax Court distinguished between the bonds purchased directly from the holders and the bonds purchased through brokers and the bondholders' committee. With respect to the bonds purchased through brokers and the bondholders' committee, the Tax Court held that the difference between the issuance price and the purchase price constituted taxable income under *United States* v. *Kirby Lumber Co.*, 284 U. S. 1. With respect to the bonds purchased through direct negotiations with the bondholders, it held that the difference between the purchase price and the issu-

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Footnote 4 continued from p. 5.

Date of purchase	D—Direct B—Broker C—Bondholders' committee	Face value	Purchase price	Percentage of face amount paid by taxpayer
1938				
Apr. 9, 1938 (R. 123-124)	D	$450	$202.50	45
June 9, 1938 (R. 124)	D	3,600	1,620.00	45
Aug. 17, 1938 (R. 124)	D	900	405.00	45
1938 (R. 124)	D	900	957.00	[1] 106
1939				
Feb. 15, 1939 (R. 124)	B	1,800	900.00	50
June 16, 1939 (R. 124)	D	450	225.00	50
Oct. 23, 1939 (R. 124)	B	180	86.50	48
1940				
Apr. 4, 1940 (R. 125)	C	270	130.00	48
May 21, 1940 (R. 125)	C	450	210.00	[1] 47
May 23, 1940 (R. 125)	C	2,700	1,080.00	40
June 19, 1940 (R. 125)	C	1,800	720.00	40
July 1, 1940 (R. 125)	B	450	[2] 185.00	41
July 3, 1940 (R. 125)	B	450	[2] 175.00	39
July 10, 1940 (R. 125)	B	450	184.50	41
Sept. 23, 1940 (R. 125)	B	450	185.00	41
Total		15,300	7,265.50	

[1] Approximate figure.
[2] Net.

ance price represented gifts under *Helvering* v. *American Dental Co.*, 318 U. S. 322. Five of the six dissenting judges of the Tax Court expressed the view that the *Kirby Lumber* case governed all the transactions here in question. (R. 132–135.) The court below, on cross-petitions for review, held that the taxpayer had acquired all the bonds by direct negotiations with the bondholders and that in all instances, to the extent of the difference between the purchase price and the issuance price, he received gifts of property exempt from income tax. Accordingly, it held that the taxpayer had not realized taxable income in any of the transactions.

SPECIFICATION OF ERRORS TO BE URGED

The court below erred:

1. In deciding that where the taxpayer purchased his own bonds at less than their face value, the taxpayer did not realize income within the meaning of Section 22 (a) of the Revenue Act of 1938 and of the Internal Revenue Code, and as provided for in the applicable Treasury Regulations.

2. In failing to decide that where the taxpayer purchased his own bonds at less than their face value, he realized income within the meaning of Section 22 (a) of the Revenue Act of 1938 and of the Internal Revenue Code, and as provided for in the applicable Treasury Regulations, regardless of whether he purchased them by direct

negotiations with the holders or through a broker or other intermediary.

3. In reversing that part of the decision of the Tax Court which held that where the taxpayer purchased his own bonds at less than their face value through a broker or other intermediary, he realized income within the meaning of Section 22 (a) of the Revenue Act of 1938 and of the Internal Revenue Code, and as provided for in the applicable Treasury Regulations.

4. In affirming that part of the decision of the Tax Court which held that where the taxpayer purchased his own bonds at less than their face value directly from the bondholders, he did not realize income within the meaning of Section 22 (a) of the Revenue Act of 1938 and of the Internal Revenue Code, and as provided for in the applicable Treasury Regulations.

SUMMARY OF ARGUMENT

I

A taxpayer who purchases his own obligations prior to maturity by paying less than the amount of his obligation thereby increases his net assets and enjoys gains which constitute taxable income. This rule has been stated in long-standing Treasury Regulations and has been approved in *United States* v. *Kirby Lumber Co.*, 284 U. S. 1, and *Helvering* v. *American Chicle Co.*, 291 U. S. 426. Contrary to the courts below, the creditor who

accepts less than the face amount of the indebtedness, but who obtains payment prior to the time that it would otherwise be due, does not make a "gift" to his debtor which is exempt from income tax. This is true regardless of whether the debtor purchases his obligations by direct negotiations with his creditor, or otherwise. There is no justifiable basis for the principle followed by the courts below that a tax-exempt gift exists whenever the debtor and creditor deal with each other in direct negotiations. Where each party to the transaction receives and gives up something of value, the transaction is not "gratuitous" and no basis exists for the conclusion that there is a gift of property exempt from income tax. The present case, in this respect, is distinguishable from *Helvering* v. *American Dental Co.*, 318 U. S. 322, where the Court found that there was a gratuitous forgiveness of a past due indebtedness and that the creditor had given "something for nothing" to his debtor; in all pertinent aspects, the case here is governed by the *Kirby Lumber Co.* and *American Chicle Co.* cases.

II

While the situation here can be distinguished from the *American Dental Co.* case, it is also urged that the language of that opinion be reexamined and clarified. It is the Commissioner's contention that a gift of property exempt from in-

come tax does not exist merely because one party to the transaction receives "something for nothing." A proper test for determining whether such a gift has been made depends upon whether the parties were actuated by a donative purpose. Such a purpose is lacking whenever they deal with each other at arm's length and in the ordinary course of business. This has always been the distinction between payments taxable as extra compensation (such as bonuses) and those which are gifts exempt from income tax. It is also the test for determining what transfers are subject to the gift tax. A transfer which is not taxable under the broad scope of the gift tax ought not to be considered a gift under the more narrow provisions of an exemption section in the income tax law. Also, various statutory provisions dealing with specific exceptions to the general rule that income is realized where an indebtedness is modified or discharged at less than the amount of the obligation, indicate that Congress has legislated on the premise that a transaction does not constitute a tax exempt gift to the debtor wherever there has been a gratuitous release by the creditor.

ARGUMENT

I

SINCE (1) SALE OF THE BONDS WAS IN NO SENSE A "GRATUITOUS" ACT ON THE PART OF THE BONDHOLDERS, (2) THE TRANSACTIONS WERE CONDUCTED ON AN ARM'S LENGTH BUSINESS BASIS, AND (3) THERE IS NO EVIDENCE THAT THE BONDHOLDERS HAD ANY INTENTION OF GIVING "SOMETHING FOR NOTHING", THE TAXPAYER REALIZED TAXABLE INCOME BY PURCHASING HIS BONDS PRIOR TO MATURITY AT LESS THAN THEIR FACE VALUE

The problem in this class of cases can be simply expressed. As part of an arm's length business transaction, a debt owed to a creditor by a solvent debtor is discharged. Regardless of the nature of the "property" or "gain" thus acquired by the debtor, he has undoubtedly received an economic benefit and has in fact realized a profit. That profit is of the type that is certainly included in the broad sweep of the definition of gross income of Section 22 (a) of the Internal Revenue Code (*United States* v. *Kirby Lumber Co.*, 284 U. S. 1; see *Helvering* v. *Bruun*, 309 U. S. 461, 469). The question is whether such profit, otherwise includible in Section 22 (a), is to be treated as a "gift" and therefore excluded from income by reason of Section 22 (b) (3).

The answer would seem clear. Since the parties were dealing with each other at arm's length in business transactions supported by consideration, since the creditors obviously had no "donative intent", and since the debtor was certainly not a natural object of his creditors' bounty, there was no

"gift" of income within the meaning of Section 22 (b) (3). The difficulties presented by this case, however, would appear to be attributable to some confusion in the lower courts arising from the language in *Helvering* v. *American Dental Co.*, 318 U. S. 322, which will be discussed later.

Since the issue here is one of statutory construction, we begin our argument by consideration of the words of the statute. Section 22 (a) of the Revenue Act of 1938 and of the Internal Revenue Code (*supra*, pp. 2–3) is couched in terms as broad as the Constitution permits. It defines taxable "gross income" to include "gains * * * derived from * * * businesses, commerce * * * or dealings in property * * *, or [from] the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *" Section 22 (a) represents the exercise by Congress of the full measure of its constitutional authority to impose a tax on all income of every nature, and the sweeping character of the definition contained in that section has frequently been noted. *Irwin* v. *Gavit*, 268 U. S. 161, 166; *Douglas* v. *Willcuts*, 296 U. S. 1, 9; *Helvering* v. *Clifford*, 309 U. S. 331, 334. See also *Commissioner* v. *Smith*, 324 U. S. 177, 181, rehearing denied, 324 U. S. 695.

It is clear at the outset, therefore, that the pecuniary gain derived by the taxpayer through the extinguishment of his obligations falls within

the comprehensive definition of taxable income contained in Section 22 (a).[2] The precise question presented in this case is whether, notwithstanding the all-embracing language of Section 22 (a), Congress has, by Section 22 (b) (3), excluded these gains from the taxpayer's gross income because they represent the "value of property acquired by gift * * *" (*supra*, pp. 2–3). This provision is, of course, to be given a restrictive construction no broader than its terms fairly imply, for it has long been established that exemptions are to be strictly construed. Cf. *Irwin* v. *Gavit, supra,* pp. 167–168; *Helvering* v. *Northwest Steel Mills,* 311 U. S. 46, 49.

The court below held that the present case is governed in all material respects by *Helvering* v. *American Dental Co.,* 318 U. S. 322, and that the taxpayer's gains from all the transactions here involved constitute a gift and not taxable income. The court stated that the "controlling feature" of the *American Dental* case was that "the debtor was dealing with its creditors in such a manner that they parted with their security at less than its face value with knowledge that the amount

[2] See Lynch, Some Tax Effects of Cancellation of Indebtedness, 13 Fordham L. Rev. 145 (1944); Warren and Sugarman, Cancellation of Indebtedness and its Tax Consequences, 40 Col. L. Rev. 1326 (1940), 41 Col. L. Rev. 61 (1941); Darrell, Income Tax on Discharge of Indebtedness, 53 Harv. L. Rev. 977 (1940); Surrey, The Revenue Act of 1939 and the Income Tax Treatment of Cancellation of Indebtedness, 49 Yale L. J. 1153 (1940).

received was in discharge of the debtor's obligation" (R. 171). It is respectfully submitted that this statement reflects a misconception of the fundamental principles governing exclusion of gifts from taxable income; that the decision in the *American Dental* case, properly construed, is consistent with the imposition of the tax in this case; and that, to the extent that the court below and other courts may have been misled by language in the *American Dental* opinion into believing that the case establishes a novel or different principle, clarification by this Court would promote consistent and proper application of the tax laws.

The obligations which are the focal point of the present controversy were issued by the taxpayer and his wife in 1925 and were secured by a mortgage trust deed. Some of the bonds were payable prior to November 1, 1931, and those were paid as they became due. The balance, $57,500 face amount, of the bonds would have become due on May 1, 1932. At that time, however, the taxpayer obtained from a bondholders' committee an extension of time for the payment of the principal of the bonds until May 1, 1937. During the extended period he continued to pay the interest. In 1937, the taxpayer paid 10 percent on account of the principal of the bonds, leaving an unpaid balance of $51,750, and in that connection secured a further extension of time for their payment

until 1942. (R. 122–123.) During the taxable years 1938, 1939 and 1940, at a time when the principal of the bonds was not yet due and when there had been no default on the interest payments, the taxpayer bought up from various bondholders a number of bonds of the face amount of $15,300, for which he paid a total of $7,265.50. These bondholders received varying percentages of the face amount of their bonds, ranging from 39 percent to 106 percent. See fn. 1, *supra*. Some of these purchases were accomplished as a result of direct negotiations between the taxpayer and the bondholders, some were acquired through a broker, and some through the secretary of the bondholders' committee. The detailed findings of the Tax Court concerning the individual transactions are set forth at pp. 123–126 of the record.

There is no proof establishing that the bondholders were giving the taxpayer something for nothing, or that they failed to obtain from the taxpayer the full amount of what they then considered to be the value of the obligation—an obligation which was not to become payable for

[3] While the bonds were originally issued by the taxpayer and his wife, there is nothing to show whether, as between the parties, she was intended to have any liability, whether she consented to the extensions of time, or even whether she was still alive. The taxpayer's evidence assumed that he was the sole obligor during the taxable years. For the purpose of this brief a similar assumption will be made for, in the absence of proof to the contrary, it must be conceded that the full amount of the gain determined by the deficiency notice was realized by and taxable to the taxpayer alone.

several more years. Indeed, not only did the taxpayer fail to present evidence to contradict these conclusions, but the only detailed testimony which he gave with respect to some of the transactions shows that the ultimate price paid came as a result of true arm's length business bargaining on both sides, with the creditors attempting to obtain the largest payment possible, and being unwilling to wait until the maturity date, and with the taxpayer attempting to pay the smallest amount possible and preferring to postpone payment as long as possible.[4] The facts in the record provide no basis for a suggestion that the taxpayer was the object of the creditors' "bounty".

Where creditors, unwilling to abide their

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[4] The taxpayer described one transaction as follows (R. 32):

> Well, '38, I noticed I had a memorandum on a piece of paper that somebody called me about that bond, and said he had Samuels' bond and represented Samuels and wanted to know how much I would pay for the bond. Samuels was overloaded with bonds. I gave him a figure, I told him if I could get the money, I would take it for 40 cents, but I didn't want to at that time, I wanted him to hang on with me and weather the storm. I didn't hear anything from him, and a year later this same company said they wanted to do something for Samuels and what could I do to get rid of Samuels' bond. We dickered and finally came to an agreement at 50 cents on the dollar, I believe, and then they said they were representing Samuels and I had to go over my whole story, all over again, told them what I had in the world, what I didn't have, what I lost and what I was worth before the crash and what happened to me after that.

debtor's ultimate financial fortunes, bargain for what they consider to be the best amounts immediately obtainable, and where the parties settle the obligation before its due date at less than the face amount, in no fair sense of the word can there be said to be a "gift" of property within the mean-

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and they finally called me up and offered me that and said they would send over the bond for the check.

Respecting another transaction, the taxpayer testified (R. 37):

> Mr. Gerding, who was the secretary of the bondholders' committee told me that some of the bondholders that drifted into his office, wanted to sell their bonds. I told him that was a question of how much money I had to buy with. He told me about Jens Hendrickson and I knew Hendrickson, he had $270.00 principal left, and I told Mr. Gerding that if he wanted to talk to Hendrickson and explain my financial condition which Gerding knew at all times, and if he wanted me to buy his bonds, I would pay him for that service. On April 4, 1940, Mr. Gerding told me that he was ready to buy Hendrickson's bonds if I back him up on it. I said, you just buy the bonds, and I will send you a check. I sent him a check for $130.00, and I said I would pay him for his trouble $7.50.

Generally, concerning the bonds which were purchased through Mr. Gerding, the secretary of the bondholders' committee, the taxpayer stated (R. 39):

> I would rather answer it this way, each one of these people where Gerding finished the deal, I talked to him previously, I gave him my statement of what I could afford to pay and I told him if they wanted to they could bring it over to Gerding, because they could find his office better than mine and they would find him in all of the time, so he was acting as my agent and closed the deal the same as I did.

ing of the exclusion provided for in Section 22 (b) (3). See *Central Paper Co.* v. *Commissioner*, 158 F. 2d 131, 134 (C. C. A. 6); *Chenango Textile Corp.* v. *Commissioner*, 148 F. 2d 296, 297 (C. C. A. 2); cf. *Fifth Ave.-Fourteenth St. Corp.* v. *Commissioner*, 147 F. 2d 453 (C. C. A. 2). The creditors here may have been mistaken in their judgment, for it might have been that the taxpayer would have been able to pay the bonds in full at their maturity; it might even have been the case that the taxpayer, if pressed, would have been willing to pay more than he did to some of the bondholders, for there was a marked variation in the amounts for which he was able to acquire the bonds, the price ranging from 39 to 50 cents on the dollar. Indeed, in one unexplained instance, he paid more than 100 cents on the dollar to one bondholder. (See fn. 1, *supra*.) And there is an express finding by the Tax Court that the taxpayer was solvent during each of the taxable years involved. Be that as it may, a debtor who is able to drive a profitable bargain does not, in any meaningful sense of the word, receive a gift, and, conversely, a creditor who makes a poor or even a foolish bargain does not thereby make a gift to his debtor.

The situation here is one where, even under the common law principles of contract law, the mutual promises (even if they had still been executory) would have been enforceable because supported by consideration. The taxpayer by promising to pay prior to maturity gave sufficient considera-

tion for the creditor's promise thereby to accept less than the amount which would have otherwise been due at maturity. *Crow* v. *Gore*, 85 F. 2d 291, 293–294 (App. D. C.); 1 Restatement of the Law of Contracts, Section 84 (c); 1 Williston on Contracts (Rev. ed., 1936), Section 121. It would be a contradiction in terms to hold that a transfer of property, pursuant to an enforceable contract supported by common-law consideration, is a "gift of property" which Congress has exempted from income tax. *Carroll-McCreary Co.* v. *Commissioner*, 124 F. 2d 303, 305 (C. C. A. 2); *Chenango Textile Corp.* v. *Commissioner, supra.*

Our argument does not imply that every transaction which lacks technical consideration, or would not be an enforceable contract at common law for any other reason, thereby automatically qualifies as a gift within the meaning of Section 22 (b) (3). Indeed, a bonus given to an employee is a familiar example of taxable income, notwithstanding the absence of any obligation on the part of the employer to make the payment. The short of this case is that Congress never intended that a gain should be viewed as a gift and exempt from the income tax when it represents the fruition of a true business bargain possessing the elements of mutual good and sufficient consideration.

Plainly, therefore, the present case is distinguishable from *Helvering* v. *American Dental Co., supra.* There, certain overdue interest and unpaid back rent were forgiven by the taxpayer's credi-

tors, who, as this Court held, received nothing of value for the release of those obligations. The Court held that the "release of something to the debtor for nothing" established that there was a gift of property under Section 22 (b) (3). But, as has been shown, in the present case each party to the transaction here has both received something of value and given up something of value.

Taking into account his present need for the money as well as his judgment of the probability of obtaining full payment at maturity, the receipt of money prior to maturity may have been as valuable to each creditor as the difference in price which he was compelled to receive. Conversely, the right to postpone payment until the date of maturity may have been as valuable to the taxpayer as was the monetary savings involved in satisfying the bonds at less than face value. These are personal elements of value which cannot be expressed in mathematical terms, for they include business judgments incapable of precise evaluation. These matters plainly forbid the conclusion that the taxpayer here received "something * * * for nothing" and that the satisfaction of the indebtedness was "gratuitous", as this Court found to be the case in the *American Dental* case.[5]

[5] Even if these elements of value were capable of measurement, the record here completely fails to establish that there was any difference in value between what the creditors gave up and what they received. As a result, there is no possible basis for holding that something gratuitous in the way of a gift passed to the taxpayer.

This case, in its pertinent facts, is governed by *United States* v. *Kirby Lumber Co.*, 284 U. S. 1, and *Helvering* v. *American Chicle Co.*, 291 U. S. 426, and by the long-standing Treasury Regulations the validity of which was specifically affirmed by those decisions. See Article 22(a)–14, Treasury Regulations 101, and Section 19.22(a)–14, Treasury Regulations 103.[6] In each of these cases, the debtor has purchased his own obligations prior to maturity and has been able to do so at less than their face amount. In each situation, being solvent, the debtor has in fact been enriched and realizes income to the extent that he is thereby able to increase his net worth.

The mistake of the Tax Court, in part, and of the Court of Appeals, in whole, results from a patent fallacy in an argument which runs as follows: There cannot be a gift unless there is some personal relationship or dealings between the parties; here there were personal dealings between the taxpayer and his creditors (in some of the transactions, according to the Tax Court—in all of the

[6] These provisions state that a taxpayer realizes income by the payment or purchase of his obligations at less than their face value, and make a cross reference to Article 22(a)–18 and Section 19.22(a)–18, which state that a corporation realizes taxable gain if it purchases its own bonds at less than the issuing price or face value. It was the latter provision which was involved in the *Kirby Lumber* and *American Chicle* cases. The principle that taxable gain is realized under these circumstances, as the Regulations plainly indicate, is equally applicable whether the taxpayer is an individual or a corporation.

transactions, according to the Court of Appeals); therefore, there were gifts here (in some of the transactions, according to the Tax Court—in all of the transactions, according to the Court of Appeals).

The defect in the reasoning is apparent, as was noted in the dissenting opinion in the Tax Court (R. 134):

> The majority opinion appears to go on the theory that all transactions carried on directly with personal acquaintances must be gratuitous. It is my opinion that while all gratuitous transactions will normally be carried on directly between personal acquaintances, not all transactions carried on directly between personal acquaintances are gratuitous. The instant case is an example.

This kind of fallacious reasoning, followed by the majority, however, has characterized some of the Tax Court's decisions in cases of this type subsequent to the decision in the *American Dental* case, *supra*. In *Fifth Avenue—14th Street Corp. v. Commissioner*, 2 T. C. 516, reversed and remanded on an evidentiary matter, 147 F. 2d 453 (C. C. A. 2), the Tax Court held that where the debtor corporation bought up its certificates of indebtedness prior to maturity and where there were no direct negotiations between the debtor and the certificate holders, the certificates being traded in the open market, there was no "gift" to the debtor. Although the Tax Court reached the correct result, it attempted to justify it on the infirm grounds of a lack of direct negotiations between

the parties. The same erroneous reasons were assigned in *Blake* v. *Commissioner*, 8 T. C. 546, although there, too, the proper result was achieved. However, in *Bulkley Bldg. Co.* v. *Commissioner*, decided October 25, 1944 (1944 P-H T. C. Memorandum Decisions, par. 44,342), where the debtor bought up its obligations at less than face value prior to maturity, some being purchased through direct transactions with the holders and some being purchased on the open market, the Tax Court ruled that the taxpayer realized taxable income where the obligations were purchased in the open market, but that non-taxable gifts resulted where the acquisitions were made through direct dealings.[7] The same distinctions

[7] The *Bulkley Bldg. Co.* case, as well as the present decision, may be contrasted with the result in *Warner Co.* v. *Commissioner*, 11 T. C. No. 53, decided September 27, 1948, where, in a decision which was not reviewed by the full Tax Court, Judge Leech (who was one of the dissenting judges in the present case) held that where the taxpayer acquired its own obligations at less than face value as a result of direct dealings, and where the prices paid were based on quoted prices in over-the-counter transactions to which the taxpayer had not been a party, there were no "gifts" and that United States v. *Kirby Lumber Co.*, *supra*, controlled. Although the rationale of the opinion is not clearly expressed, it would seem plain that the controlling circumstance was that the "price" paid by the taxpayer was fair, a fact which was undeniable since the price was established by reference to other arm's length transactions and since the transactions in question were also conducted at arm's length. In such circumstances, the existence of a gift is conclusively negated. The Tax Court, in the *Warner* case, seems to have impliedly accepted what the Commissioner here contends is the proper approach to the construction of the statute.

were drawn in the present case and in *Edmont Hotel Co. v. Commissioner*, 10 T. C. 260, pending on the Commissioner's petition for review in the Court of Appeals for the Fifth Circuit.

It was by the application of this illogical rule that the Tax Court decided the present case. In all circumstances where the taxpayer was believed to have acquired his bonds as a result of direct negotiations with the bondholders, the Tax Court ruled that there was a tax exempt gift. However, where the taxpayer employed an intermediary to effectuate the purchase, it was held that there was no gift and that income was realized by the taxpayer. The Court of Appeals followed the same essential principle, but it disagreed with the Tax Court's evaluation of the evidence and, concluding that in all instances (even where the taxpayer acted through an intermediary) there were direct negotiations between the taxpayer and the bondholders, it held that there were gifts by the bondholders to the taxpayer, and that he realized income in none of the transactions.[8] Somewhat

[8] The Court of Appeals seemed to think (R. 169–170) that the only difference between the *Kirby Lumber* and *American Chicle* cases, on the one hand, and the *American Dental* case, on the other, was the fact that in the former the bonds were acquired as a result of open market transactions while in the latter the cancellation of the indebtedness was achieved by direct negotiations between the debtor and his creditors. The court thus overlooked one important difference, which also serves to distinguish this case, namely, that in the *American Dental* case nothing of value was received by the creditor for the satisfaction of the obligation and, if that

the same kind of error characterized the decision of the court below in *Shellabarger Grain Products Co.* v. *Commissioner*, 146 F. 2d 177, where an obligation was paid prior to maturity at less than face value.[9]

We submit that the question whether a taxpayer has received a tax exempt gift under Section 22 (b) (3) cannot be resolved by the application of this kind of spurious principle.[9] Where, as here, values are exchanged in the transaction and the parties arrive at their agreement as the result of the exercise of business judgments, there is nothing gratuitous about the situation and there can be no tax exempt gift[10] of property within the purview of Section 22 (b)

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sense, what passed to the debtor was "gratuitous." The *Kirby Lumber* and *American Chicle*, as well as the present case, are different in that respect. Moreover, while the opinion in the *Kirby Lumber* case (284 U. S. 1, 2) did state that the bonds there were purchased in the "open market", the record in the case does not actually disclose how the purchases were effectuated or negate the existence of direct dealings between the debtor and the bondholders.

[9] In *A. M. Campau Realty Co.* v. *United States*, 69 F. Supp. 133, where the taxpayer purchased directly from its bondholders its own bonds which were in default, the Court of Claims, emphasizing the direct dealings, indicated by *dictum* that there was a partial gratuitous forgiveness of the indebtedness which was a gift under the *American Dental* decision. This opinion was vacated and withdrawn when a new trial was granted on July 7, 1947 (1947 C. C. H., par. 9335).

[10] For a criticism of the application of the *American Dental* doctrine to the present situation, as well as a disapproval of the doctrine itself, see 61 Harv. L. Rev. 1258.

(3). And certainly, where the same essential values are exchanged, the transaction does not fall within or without Section 22 (b) (3), depending merely upon whether the parties had direct negotiations or whether they dealt with each other through a market where securities are bought and sold.

II

THE EXISTENCE OF A GIFT UNDER SECTION 22 (b) (3) IS NEGATED WHERE THE TRANSACTION HAS A BUSINESS NATURE AND WHERE A DONATIVE INTENT IS ABSENT

Since, in accepting payment prior to maturity of an amount less than the face value of their bonds, the bondholders here did not extend anything gratuitous to the taxpayer, *Helvering* v. *American Dental Co.*, 318 U. S. 322, is plainly distinguishable for the reasons which have been set forth. The opinion in that case, however, contains language (particularly at pp. 330–331) which has given rise to confusion and misunderstanding in the Tax Court and other lower courts. The opinion states that there is a "gift of property" exempt from income tax under Section 22 (b) (3) wherever the "forgiveness" is "gratuitous", a "release of something to the debtor for nothing", and that the "fact that the motives leading to the cancellations were those of business or even selfish, if it be true, is not significant" (p. 331). This language, if taken literally, would suggest a construction of Sec-

tion 22 (b) (3) far beyond that intended by Congress and, we believe, by the Court. This language, unless clarified in the present case, will continue to be a source of considerable confusion to the lower courts and the bar. We urge the following considerations as grounds for clarifying the language appearing in the *American Dental* case.

A. *The intention of the parties is an important element for distinguishing between income subject to tax and property exempt as a gift*

The touchstone to the exclusion provisions of Section 22 (b) (3) lies in the intention that accompanies the transaction, rather than in academic notions of what would have been enforceable by the parties if their purposes had not actually achieved fruition and if the matter were still executory. Thus, the dividing line between a payment which, if compensatory, would be taxable income to the recipient, and a gift which would be tax exempt, has always been held to turn on the intention with which it was made. *Old Colony Tr. Co.* v. *Commissioner*, 279 U. S. 716, 730; *Bogardus* v. *Commissioner*, 302 U. S. 34. Both the majority and the minority in the *Bogardus case*, despite their differences regarding the proper function of the reviewing court, agreed that a payment intended as extra compensation for past services (which would not have been enforceable as an executory contract)

would not be a tax exempt gift. See also *Helvering* v. *Nat. Grocery Co.*, 304 U. S. 282, 289, fn 5, where it was said: "Whether a payment received is compensation within Section 22 (a) or is a gift within Section 22 (b) (3) is largely a matter of intention." See *Commissioner* v. *Smith*, 324 U. S. 177, 181–182.

The *American Dental* opinion, in appearing to make the "gratuitous" nature of the transaction the sole test of the existence of a tax-exempt gift, has unduly enlarged the scope of Section 22 (b) (3). Thus, in every sense of the word, the payment of additional compensation to an employee is "gratuitous." If the simple test of "something * * * for nothing" were employed and if the intention of the parties were completely disregarded, this type of payment, which is fairly frequent in the business world, would escape taxation as compensation to the employee, even though the employer clearly intended it to be compensatory. The *American Dental* language, if followed literally, would conflict with the principles of the *Bogardus* and *Old Colony Tr. Co.* cases even though those decisions were cited with approval there. We submit that a proper test under Section 22 (b) (3) must include the one applied in an impressive number of cases in the lower courts in following the ruling of the *Bogardus* and *Old Colony Tr. Co.* cases, namely, whether the parties intended a gift. See, e. g., *Fisher* v. *Commissioner*, 59 F. 2d 192 (C. C. A. 2); *Nickelsburg* v.

Commissioner, 154 F. 2d 70 (C. C. A. 2), and other cases cited in 1 Mertens, Law of Federal Income Taxation, Section 8.08, where such payments were taxed as compensation. The same test should possess great weight in determining the nature of payments between all parties, regardless of whether the relationship is that of employee-employer or that of debtor-creditor.

B. *A transfer made in the ordinary course of business is not taxable under the gift tax statute. The same transaction should not be a gift exempt from income tax*

Another reason why the *American Dental* opinion, if taken literally, would unduly enlarge the meaning of the word "gift" in Section 22 (b) (3) seems apparent from the relation between the exclusion provisions of the income tax and the coverage of the gift tax. The term "gift," as used in the gift statute, was employed in its most comprehensive sense. H. Rep. No. 708, 72d Cong., 1st Sess., p. 27 (1939–1 Cum. Bull. (Part 2) 457, 476); S. Rep. No. 665, 72d Cong., 1st Sess., p. 39 (1939–1 Cum. Bull. (Part 2) 496, 524); *Commissioner* v. *Wemyss*, 324 U. S. 303, 306. The gift tax statute, generally, dispensed with the test of donative intent and formulated one which employs the standard whether the transfer is for less than an adequate and full consideration in money or money's worth. Section 1002, Internal Revenue Code (26 U. S. C. 1002). Despite the sweeping nature of the con-

cept of gifts which Congress employed in imposing a tax on such transfers—a tax designed to implement the estate tax—it is important that "no genuine business transaction comes within the purport of the gift tax" (*Commissioner* v. *Wemyss*, *supra*, pp. 306–307). The Treasury Regulations plainly state that transfers "made in the ordinary course of business" are considered as made for an adequate and full consideration. Transactions made in the ordinary course of business are defined by the Treasury Regulations as "bona fide, at arm's length, and free from any donative intent." Section 86.8, Treasury Regulations 108, promulgated under the Internal Revenue Code. See II Paul, Federal Estate & Gift Taxation and 1946 Supp., Sections 16.07 and 16.14.

Thus, since ordinary business transactions are excluded from the scope of the gift tax, the creditors' forgiveness of the indebtedness in the *American Dental* case would seem not to be taxable as a gift because what occurred there appeared to be "bona fide, at arm's length, and free from any donative intent."[11]

Although a perfect integration between the estate, gift and income taxes is lacking, it is clear, at least, that a transaction which does not fall

[11] In the proper circumstances, forgiveness of a debt when not done in the ordinary course of business can constitute a taxable gift, and the Regulations so provide. See Section 86.2, Treasury Regulations 108.

within the sweeping coverage of the gift tax certainly cannot come within the exclusion provisions of the income tax under Section 22 (b) (3). See Paul, *supra*, 1946 Supp., Section 16.07. The word "gift" is unquestionably more embracing in its coverage under the gift tax statute than it is when used in an exemption section of the income tax. The *American Dental* language is, we respectfully submit, wrong in its implication that the contrary is true.

Even if the term "gift" in the two statutes were coextensive in coverage, and if the choice must be between taxing as income to the solvent debtor the amount of his cancelled indebtedness, or taxing as a gift by the creditor the debt which he foregoes as a result of a good faith business transaction, it is believed that the former would be the result more probably intended by Congress. See Lynch, Some Tax Effects of Cancellation of Indebtedness, 13 Fordham L. Rev. 145, 168 (1944).

It is urged that where the intention of the parties negates a donative purpose and where the forgiveness of an indebtedness is the result of an ordinary business transaction, there is no gift of property which is exempt from income tax by reason of Section 22 (b) (3). The application of this rule to the present case requires, *a fortiori*, the conclusion that the taxpayer did not receive a gift from the bondholders which would be exempt from income tax. It would also require the conclusion that no gift of property exempt under

Section 22 (b) (3) is involved in any situation where there is a reduction or cancellation of an indebtedness—without regard to whether this is accomplished before or after maturity, whether adequate, common law consideration is present or absent, and whether the transaction takes place in the open market or as a result of direct negotiations between the parties. If the creditor acts out of business reasons which preclude the existence of a donative purpose, there can be no gift of property within the intendment of Section 22 (b) (3).

C. *Legislation relating to cancellation of indebtedness shows that Congress does not conceive of a tax exempt gift occurring in a business transaction*

Congress has recognized the soundness of the rule that taxable income is realized when a debtor is able to discharge his indebtedness by payment of less than the amount of the obligation, and has, in effect, given legislative affirmation to the decisions in the *Kirby Lumber Co.* and *American Chicle Co.* cases by providing certain exceptions to the rule, but only under specified circumstances. The legislation, moreover, raises serious doubts respecting the correctness of the inferences to be drawn from the *American Dental* opinion.

Section 22 (b) (9), Internal Revenue Code,[9]

[9] As added by Section 215 (a) of the Revenue Act of 1939, c. 247, 53 Stat. 862, and as amended by Section 114 (a) of the Revenue Act of 1942, c. 619, 56 Stat. 798. Section 152 of the

provides that in the case of a corporate taxpayer there shall not be included any income attributable to the discharge of any indebtedness which is evidenced by a security if the taxpayer consents to an adjustment in basis as provided for in the Treasury Regulations promulgated under Section 113 (b) (3) of the Internal Revenue Code. As presently constituted, Section 22 (b) (9) is effective only with respect to discharges of indebtedness occurring after the enactment of the Revenue Act of 1939 and before December 31, 1949.

Section 22 (b) (10) of the Internal Revenue Code[13] provides that in the case of a railroad corporation, there shall be excluded any income attributable to the discharge of any indebtedness by reason of a modification or cancellation of such indebtedness pursuant to an order of a court in a receivership proceeding or in a proceeding under Section 77 of the Bankruptcy Act, as amended. This section, too, is not effective with

Revenue Act of 1945, c. 453, 59 Stat. 556, Section 1, Act of July 31, 1946, c. 717, 60 Stat. 749, and Section 3, Joint Resolution of June 25, 1947, 61 Stat. 179 (26 U. S. C., Supp. I, 22 (b) (9)). Section 113 (b) (3) of the Internal Revenue Code, dealing with adjustments in basis, was also added by Section 215 (b) of the 1939 Act, *supra*.

[13] As added by Section 114 (b) of the Revenue Act of 1942, c. 619, 56 Stat. 798, and as amended by Section 152 of the Revenue Act of 1945, c. 453, 59 Stat. 556, Section 1, Act of July 31, 1946, c. 717, 60 Stat. 749, and Section 3, Joint Resolution of June 25, 1947, 61 Stat. 179 (26 U. S. C., Supp. I, 22 (b) (10)).

respect to discharges occurring after December 31, 1949. Unlike Section 22 (b) (9), *supra*, there is no provision requiring an adjustment in basis.

Various sections of the Bankruptcy Act provide that no income in respect to the adjustment of the indebtedness of the debtor shall be deemed to have been realized by reason of a modification in or cancellation of an indebtedness under the proceedings provided for in several of the chapters. See: Sections 268–270 of the Bankruptcy Act of July 1, 1898, c. 541, 30 Stat. 544, as added by Section 1 of the so-called Chandler Act, Act of June 22, 1938, c. 575, 52 Stat. 840, 904, and amended by Section 1, Act of July 1, 1940, c. 500, 54 Stat. 709 (11 U. S. C. 668–670), relating to proceedings under Chapter X of the Bankruptcy Act, dealing with corporate reorganizations;[14] Sections 395–396 of the Bankruptcy Act, as added by the Chandler Act and as amended by Section 2, Act of July 1, 1940, *supra* (11 U. S. C. 795–796), relating to arrangements under Chapter XI of the Bankruptcy Act; Sections 520–522 of the Bankruptcy Act, as added by the Chandler Act and as amended by Section 3 of the Act of July 1, 1940, *supra* (11 U. S. C. 920–922), relating to real property arrangements by persons other than corporations under Chapter XII of the Bankrupty Act; Section 679 of the Bankruptcy Act, as added by the Chandler Act (11 U. S. C. 1079),

[14] *See Claridge Apartments Co. v. Commissioner*, 323 U. S. 141.

relating to wage earners' plans under Chapter XIII.

Under the excess profits tax statute (which has since been repealed) in computing the credit based on average income, Congress provided that there should not be included in the excess profits net income of years in the base period any income derived from the retirement or discharge of certain evidences of indebtedness if the obligation was outstanding for more than six months. See former Section 711 (b) (1) (C), Internal Revenue Code, which was added by Section 201, Second Revenue Act of 1940, c. 757, 54 Stat. 974, as amended by Section 207 (f), Revenue Act of 1942, c. 619, 56 Stat. 798.

The recognition by Congress of the need for some measure of "relief" or special treatment in these particular circumstances is, of course, cogent evidence that the basic principles underlying the *Kirby Lumber* and *American Chicle* cases possess continuing vitality. Unless a particular taxpayer can bring himself within the specific circumstances in which Congress has seen fit to postpone or to forgive the imposition of a tax on the gains, there is no reason for the creation of artificial judicial exceptions. As was pointed out in the dissenting opinion in the *American Dental* case, *supra*, p. 331, "When Congress wished to exempt income attributable to the discharge * * * of any indebtedness it did so explicitly."

It is significant that in all the above instances

(with the exception of railroad reorganizations and wage earners' plans), Congress provided for certain readjustments in the basis of property, with the result that, to some extent at least, taxation of the profit realized through the discharge of the indebtedness is *merely postponed* until some future time. This should be contrasted with the result reached in the present case by the court below where the effect of the decision is to permit the taxpayer to escape taxation on the gains for all time.

The legislative measures, moreover, reveal the absence of any substantial basis for drawing the line, as the courts below did, between open market transactions and those resulting from direct negotiation. The discharge of an indebtedness by a modification or cancellation through the various proceedings provided for in the Bankruptcy Act do not, of course, result from open market transactions. Actually, agreement between the debtor and his creditors may frequently result in an acceptable plan. Consequently, it seems quite clear that Congress never envisaged a rule that discharges of indebtedness resulting from personal negotiations were, in all instances, to be automatically classified as tax exempt gifts of property to the debtor. On the contrary, Congress made exceptions to the general rule only in the enumerated instances, and those were not treated as tax exempt gifts to the debtor.

Furthermore, the legislation does not reveal that Congress shared the view expressed in the *American Dental* opinion that the modification or cancellation of the indebtedness is a gift to the extent that the debtor receives "something for nothing" from the creditor. In many instances where there are proceedings under the Bankruptcy Act, the creditor may receive nothing for the modification, reduction or cancellation of the debt. And even under Section 22 (b) (9), where the debtor purchases its obligation at less than face value after a default has occurred, the debtor receives something for nothing, as that phrase appears to have been used in the *American Dental* case, even though the obligation is acquired on the open market. See *Blake* v. *Commissioner*, 8 T. C. 546, where it was held that the debtor realized such income even though some of the bonds were purchased after they were in default.

The language in the *American Dental* opinion is therefore inconsistent with the Congressional understanding of the problem as evidenced by the foregoing legislative exceptions. See Eisenstein, Some Iconoclastic Reflections on Tax Administration (1945), 58 Harv. L. Rev. 477, 516, fn. 224.

CONCLUSION

The decision of the court below is erroneous and should be reversed with directions that the decision of the Tax Court be reversed on the Commissioner's petition for review and affirmed on the taxpayer's petition for review.

Respectfully submitted.

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OCTOBER 1948.

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IN THE

Supreme Court of the United States

OCTOBER TERM, A. D. 1947

Nos. [redacted] 32
33

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

vs.

LEWIS F. JACOBSON,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

BRIEF FOR THE RESPONDENT IN OPPOSITION.

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IN THE

Supreme Court of the United States

OCTOBER TERM, A. D. 1947

Nos. 650-651

COMMISSIONER OF INTERNAL REVENUE.

Petitioner,

vs.

LEWIS F. JACOBSON,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

BRIEF FOR THE RESPONDENT IN OPPOSITION.

STATEMENT OF CASE.

The following additional facts should be considered in connection with petitioner's statement of the case (P. Br. 3-7):

(a) The total amount of taxes involved in the issue presented by the Petition for Certiorari is $580.76 for the year 1938, $255.89 for the year 1939, and $1,603.23 for the year 1940.*

(b) The court below accepted the Tax Court's finding that the taxpayer was solvent during the years in question, but found that a perusal of the record made it quite apparent that he was in straitened financial circumstances. (R. 167)

(c) With respect to the method of making the purchase of bonds, the court below summarized the findings of the Tax Court and the evidence in the record concerning which the Tax Court made no contrary finding (R. 168-169). The sole issue involved, which was recognized by both the Tax Court and the court below, was whether the rule of this Court as announced in *United States* v. *Kirby Lumber Company*, 284 U.S. 1 (1931) or the rule announced in *Helvering* v. *American Dental Company*, 318 U.S. 322 (1943) applies to the facts in this case. (R. 128, 169)

The Tax Court and the court below agreed as to the proper rule with respect to certain of the transactions but differed as to the proper rule with respect to what the court below termed "nebulous" changes in the facts. (R. 172)

*These figures emerge from a computation of the tax resulting from the income sought to be included by the Commissioner as a result of the purchases of these bonds. There were other issues not here involved which affected the deficiency found to be due by the Tax Court. (R. 154)

ARGUMENT.

1. (P. Br. 7-8) A thorough analysis of the decisions of the Tax Court and the Circuit Court of Appeals for the Seventh Circuit in this case clearly indicates that there was no confusion as to the proper interpretation of the two decisions of this Court, *United States* v. *Kirby Lumber Company*, *supra*, and *Helvering* v. *American Dental Company*, *supra*. The only point of difference between the Tax Court and the Circuit Court of Appeals was whether the facts of this particular case came within the rule of the *Kirby Lumber Company* case or the *American Dental Company* case. The real issue was primarily a factual one and was not whether the *American Dental Company* case overruled or limited the holding in the *Kirby Lumber Company* case. Both courts recognized the rules announced in these two cases and differed only on the question as to which rule should be applied to this particular factual situation.

2. (P. Br. 9-11) There is no conflict between the decision in this case and that of the Circuit Court of Appeals for the Sixth Circuit in *Central Paper Company* v. *Commissioner*, 158 F. (2d) 131 and the decision of the Circuit Court of Appeals for the Second Circuit in *Fifth Ave.-Fourteenth Street Corp.* v. *Commissioner*, 147 F. (2d) 453. These two latter cases involved a taxpayer purchasing either trustee certificates or mortgage certificates on the *open market*. In such a situation both courts correctly applied the rule of the *Kirby Lumber Company* case.

The court below in this case recognized and stated that if the bonds had been purchased on the open market by the taxpayer, the *Kirby Lumber Company* case would have applied. It held in effect that there can be no gratuitous

cancellation of indebtedness within the meaning of the *American Dental Company* case where open market purchases are involved because the creditor has no idea that he is gratuitously cancelling a part of his claims against his debtor. The Court pointed out that in this case there were no open market purchases.

Actually the decision in this case is not only in all respects consistent with, but, in effect, reaffirms the holding in these two cases that where a corporation purchases at a discount its bonds on the open market, the rule of the *Kirby Lumber Company* case applies. These two cases were cited in the brief of the Commissioner in the court below and were thus included in the opinion of the court as among the cases having no bearing upon a state of facts such as is presented in this case. (R. 171)

The other two cases cited by petitioner, *Shellabarger Grain Products Co.* v. *Commissioner*, 146 F. (2d) 177 (C.C.A. 7th) and *A. M. Campau Realty Co.* v. *United States*, 69 F. Supp. 133 (Ct. Cl. 1947) clearly affirm and are consistent with the holding of the court below in this case.

3. (P. Br. 11-12) The decision in this case is not wrong. We wish to point out that the only similarity between the facts of this case and the *Kirby Lumber Company* case is that the indebtedness in both cases was evidenced by bonds. In all other material respects, the facts were entirely different. The only difference between the facts of this case and those in the *American Dental Company* case is that the indebtedness in this case was evidenced by bonds, while in the *American Dental Company* case it was evidenced by an open account and interest on notes. Obviously the form of the indebtedness, whether bonds, notes, or open account has no bearing on whether its cancellation was gratuitous.

Every court which has been presented with a factual

situation similar to that in this case has held the same as the court below. See *Bulkley Building Company* v. *Commissioner*, T.C. (M) No. 109679, CCH. Dec. 14206 (M); *Shellabarger Grain Products Co.* v. *Commissioner*, 146 F. (2d) 177 (C.C.A. 7th); *A. M. Campau Realty Company* v. *United States*, 69 F. Supp. 133 (Ct. Cl. 1947).*

4. (P. Br. 12-14) The petitioner takes the position that the fact that the bondholders attempted to get as high a price as possible from the taxpayer for the cancellation of their bonds negatives the idea that their cancellation of the balance due on the bonds was gratuitous. Undoubtedly in the *American Dental Company* case the creditor attempted to get as much money as possible from the taxpayer, the American Dental Company. This obviously has no bearing upon whether the cancellation of the indebtedness was gratuitous or not. This Court stated in the *American Dental Company* case:

> "The fact that the motives leading to the cancellations were those of business or even selfish, if it be true, is not significant." (p. 331)

5. (P. Br. 14) The case is not of general importance. It is respectfully submitted that an intelligent application of the principles already enunciated by this Court can resolve all cases pending. Neither is there any reasonable assurance that a decision by this Court in this case will materially aid in the determination of the other cases with different factual situations. This Court recognized in the *American Dental Company* case (p. 327) that the issue

Edmont Hotel Company v. *Commissioner*, 10 T.C. No. 31 (1948), cites the decision of the court below with approval as to one branch of the case, but held there must be some personal acquaintance between the creditor and the debtor in order to come within the ruling in the *American Dental Company* case. This distinction has no substance.

was a narrow one and thus dependent upon slight variations in the facts. Subsequent decisions of other courts reveal no conflict on principle but depend on particular facts in each case.

CONCLUSION.

The decision below is correct. There is no conflict between the decision in this case and the decision of any other Circuit Court of Appeals in a similar case. The only question involved in this case is whether the facts of this case are similar to those of the *United States* v. *Kirby Lumber Company* case or those of the *American Dental Company* case. The amount involved in this case is only $2,439.88. Clearly this is not the type of dispute which should be reviewed by this Court. The petition for writ of certiorari should, therefore, be denied.

Respectfully submitted,

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March 24, 1948.

In the Supreme Court of the United States

32 OCTOBER TERM, 1948. 33

Nos. 32 and 33.

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

vs.

LEWIS F. JACOBSON,
Respondent.

ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

BRIEF ON BEHALF OF LEWIS F. JACOBSON.

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In the Supreme Court of the United States

OCTOBER TERM, 1948.

Nos. 32 and 33.

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

vs.

LEWIS F. JACOBSON,
Respondent.

ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

BRIEF ON BEHALF OF LEWIS F. JACOBSON.

OPINIONS BELOW.

The opinion of the Court of Appeals for the Seventh Circuit (R. 166-174) is officially reported in 164 F. 2d 594. The opinion of the Tax Court of the United States (R. 120-135) is reported in 6 T. C. 1048.

JURISDICTION.

The judgment of the Court of Appeals for the Seventh Circuit was entered on December 5, 1947 (R. 174-175). The petition for writs of certiorari was filed on March 5, 1948 and granted on April 5, 1948 (R. 177). The jurisdiction of this Court is conferred by Title 28, United States Code, Section 1254.

QUESTIONS PRESENTED.

The ultimate question presented in this case is whether the court below properly held that the taxpayer did not realize taxable income within the meaning of Section 22(a) and (b) of the Revenue Act of 1938 and the Internal Revenue Code because of his purchase at a discount of his own mortgage bonds, as a result of transactions carried out between the taxpayer and the bondholders.

This ultimate question can be broken down into two subsidiary issues, which are:

1. Within the framework of the existing decisions of this Court, is any gain resulting from the taxpayer's purchase of his bonds at a discount excluded from taxable income as a gift under Section 22(b)(3) of the Revenue Act of 1938 and the Internal Revenue Code?

2. In view of the basic conceptions of income, is the cancellation of indebtedness here "income" within the meaning of Section 22(a) of the Revenue Act of 1938 and the Internal Revenue Code?

STATEMENT.

Petitioner's statement of facts contains an accurate summary of most of the pertinent facts found by the Tax Court. We point out, however, that the references to purchases of bonds by the taxpayer through "brokers" or through "the Bondholders' Committee" (Petitioner's Brief pp. 5 and 6) in no sense means open market purchases. In each instance the broker or Secretary of the Bondholders' Committee was acting either as agent of one party or the other, both the bondholder and the taxpayer having full knowledge of such agency. For the purpose of its opinion the Court of Appeals, after reviewing the undisputed evidence as to these purchases in detail, considered them to be purchases made through agents with full knowledge on both sides of the agency. The Court of Appeals,

accepted the Tax Court's finding that the taxpayer was solvent during each of the years in question, but noted that "a perusal of the record makes it quite apparent that he was in straitened financial circumstances." (R. 166-172.)

SUMMARY OF ARGUMENT.

I.

In *Helvering v. American Dental Co.*, 318 U. S. 322, this Court held that where creditors forgave the unpaid portion of the taxpayer's indebtedness upon its partial payment, the resulting gain in the taxpayer's net assets, received gratuitously, was a gift excluded from taxable income by Section 22(b)(3) of the Revenue Acts and the Internal Revenue Code. In the present case the taxpayer received a partial forgiveness of his indebtedness by purchasing certain of his outstanding bonds at less than their face amount in direct transactions with his creditors. Such gratuitous cancellation of his indebtedness was a gift excluded from his taxable income under the *American Dental Co.* case.

The only distinction the Petitioner claims between the *American Dental Co.* case and this is that here the creditors received technical legal consideration in that the bonds had not yet matured. This distinction is of no significance. The principle of contract law, that prepayment is sufficient consideration for an executory contract, is a highly technical one to avoid hardships and is inapplicable in practical matters of taxation. The lower courts have uniformly recognized that such technical legal consideration is immaterial under the *American Dental Co.* case. Even in a contract sense, such prepayment is consideration only where intended by the parties as such, which was not the case here.

The arguments presented by the Petitioner that the opinion in the *American Dental Co.* case, and its holding, should in effect be overruled, are simply those previously

presented to this Court and properly rejected in that case. The facts of *United States v. Kirby Lumber Co.*, 284 U. S. 1, where this Court held that the taxpayer's purchase of its bonds on the open market resulted in taxable income, are distinguishable, as this Court recognized in the *American Dental Co.* case. In an open market transaction the creditors could not have intended to forgive the indebtedness and hence there was no gift. Congressional enactments since the *Kirby Lumber Co.* and *American Dental Co.* cases do not indicate any Congressional understanding or intent that cancellations of indebtedness generally should be considered income, but rather approve this Court's previous holdings.

II.

If this Court desires to re-examine the *American Dental Co.* case, as the Petitioner requests, it should also re-examine its holding in the *Kirby Lumber Co.* case. An application of the basic conceptions of income, in the light of this Court's decisions in related situations, makes it clear that a forgiveness of indebtedness arrived at in a self-contained arm's length transaction, such as is here involved, does not result in income. The language of the Sixteenth Amendment, the Revenue Acts and the Treasury Regulations all recognize that income is gain *derived from* capital or from labor or from both combined. Any gain resulting to this taxpayer from the partial forgiveness of his indebtedness in an arm's length transaction was not derived from capital or labor and hence cannot be considered income.

Not all gains are taxable income. A cancellation of indebtedness, like a gain from a bargain purchase, may be a gift, if occasioned by a desire to benefit the taxpayer. It may be income, if derived from the taxpayer's services or resulting from his ownership of stock. But if it is not derived from taxpayer's labor or capital, it is not income.

ARGUMENT.

I.

WITHIN THE FRAMEWORK OF THIS COURT'S DECISIONS, THE CANCELLATION OF INDEBTEDNESS HERE WAS A GIFT EXCLUDED FROM TAXABLE INCOME.

A. This Case Is Controlled by Helvering v. American Dental Company, 318 U. S. 322.

In the *American Dental Co.* case this Court held, after most careful consideration, that where creditors gratuitously forgave back interest and rent the amount forgiven was not to be included in taxable gross income under Section 22(a) of the Internal Revenue Code because it was an exempt gift under Section 22(b)(3) of that Code, stating in part at 318 U. S. 327-31:

> "Normally cancellations of indebtedness occur only when the beneficiary is insolvent or at least in financial straits. Possibly because it seems beyond the legislative purpose to exact income taxes for savings on debts, the courts have been astute to avoid taxing every balance sheet improvement brought about through a debt reduction. * * *" (327)
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> * * *
>
> "In the light of these views upon gain, profit and income, we must construe the meaning of the statutory exemption of gifts from gross income by § 22(b)(3). The broad import of gross income in § 22(a) admonishes us to be chary of extending any words of exemption beyond their plain meaning. Cf. *Heiner v. Colonial Trust Co.*, 275 U. S. 232, 235; *United States v. Stewart*, 311 U. S. 60, 63. 'Gifts,' however, is a generic word of broad connotation, taking coloration from the context of the particular statute in which it may appear. Its plain meaning in its present setting denotes, it seems to us, the receipt of financial advantages gratuitously.
>
> "The release of interest or the complete satisfaction of an indebtedness by partial payment by the volun-

tary act of the creditor is more akin to a reduction of sale price than to financial betterment through the purchase by a debtor of its bonds in an arm's length transaction. * * *" (329-30)

* * *

"* * * Section 22(b)(3) exempts gifts. This does not leave the Tax Court of the United States free to determine at will or upon evidence and without judicial review the tests to be applied to facts to determine whether the result is or is not a gift. The fact that the motives leading to the cancellations were those of business or even selfish, if it be true, is not significant. The forgiveness was gratuitous, a release of something to the debtor for nothing, and sufficient to make the cancellation here gifts within the statute." (330-31)

The only significant difference claimed by the Petitioner between the facts of the *American Dental Co.* case and the present case is that here the bonds were purchased before maturity at a discount and the cancellation of the remaining debt by the creditors was therefore supported by technical legal consideration. In the *American Dental Co.* case this was not true. There some creditors forgave past due interest without any technical legal consideration other than the continued good will of a customer and a landlord agreed to accept payment of $7,500 in lieu of a much larger amount for past due rent.

In both the *American Dental Co.* case and the present case the taxpayers, although not insolvent, were in straitened financial circumstances. After negotiating and dealing directly with their respective creditors the taxpayers in both cases obtained a cancellation of a portion of their obligations by making a partial payment. In both cases the taxpayers and their creditors dealt at arm's-length and attempted to achieve the best financial outcome from their own selfish points of view. In both the creditors knew that they were settling their claims against the debtor for a smaller amount than actually owed and intended the debtor to obtain the benefit of the cancellation. In both,

the only valuable consideration that passed between the parties was the partial payment.

In the *American Dental Co.* case there was a prepayment in the business sense. Except by such a settlement the landlord, in order to receive payment of his claim, would have had to await the uncertain outcome of legal proceedings. If prepayment is presumed to be an important consideration in this case, it was so in the same sense in the *American Dental Co.* case.

The slight difference in fact, namely the existence in the present case of a technical legal consideration and its absence in the *American Dental Co.* case, is not a sound basis for distinction and for these reasons:

First: This rule of contract law regarding prepayment of a debt was developed by the courts to alleviate the harshness of the common law rule that the payment of a smaller sum than that due is not sufficient consideration to support a promise to forgive the balance and has always been recognized as highly technical.[1] Taxation is a practical matter and the courts will always look through form to substance in resolving tax questions. When this Court

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[1] In *Crow v. Gore et al.*, 85 F. 2d 291 (App. D. C. 1936), one of the cases cited by the Petitioner (Pet. Brief 19), the court stated at pp. 293-294:

> "* * * It is said in 6 *R. C. L.* 665: 'At an early date the rule that the performance of a legal obligation does not furnish a consideration for a contract was applied to a promise to discharge a liquidated debt upon the payment of a smaller sum on the date fixed by the contract or after default. * * * As the rule is not favored the decisions indicate in a striking manner the extreme ingenuity of the courts in avoiding its operation. They have failed to apply the rule whenever they could discover *some circumstance, however trifling, which would be considered as a technical legal consideration.* Accordingly, if the creditor accepts a part payment in a manner different from that required by the contract or before the maturity of the debt, a sufficient new and additional consideration for his promise to discharge the entire debt is deemed to be present." (Emphasis here and elsewhere supplied.)

referred to the gratuitous cancellation of indebtedness or the release by the creditor to the debtor of something for nothing, it intended that the criterion or standard to be applied is not whether there was any technical consideration to support the forgiveness but whether the creditor received anything of real value over and above the part payment. To read into the language of the *American Dental Co.* case the qualification that any technical consideration for the cancellation makes it non-gratuitous and taxable would completely emasculate the effect of that decision.[2]

Second: All lower courts, in interpreting the rule of the *American Dental Co.* case, have recognized that whether a particular cancellation is gratuitous depends not on whether there was any technical consideration to support the cancellation but whether the creditor received anything of real value for it. In many cases decided since the *American Dental Co.* case there has been sufficient consideration within the meaning of contract law to support the promise of the creditor to forgive a portion of the debt. However, in all of these cases the courts held the cancellation gratuitous in spite of the presence of technical legal consideration.[3] Whether prepayment is sufficient consideration to make a cancellation of an indebtedness non-gratuitous has been litigated in two lower court cases. These are *Shellabarger Grain Products Co., v. Commissioner*, 146 F. (2d) 177 (C. C. A. 7th, 1944), which involved a taxpayer satisfying a note for $28,030.30 by a cash payment of $20,000.00 in advance of the due date, and *Bulkley*

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[2] It would then be held that the *American Dental Co.* decision would not apply if a partial payment was made in a medium of payment different from that provided or at a different place or to someone other than the creditor. See *Williston on Contracts*, Rev. Ed. Section 121.

[3] *McConway & Torley Corp. v. Commissioner*, 2 T. C. 593 (1943); *Tanner Mfg. Co. v. Commissioner*, Doc. 110068, 2 T. C. (M) 305, CCH Dec. 11319 (M); *Chenango Textile Corp. v. Commissioner*, 148 F. 2d 296 (C. C. A. 2, 1945); and *Carroll-McCreary Co. v. Commissioner*, 124 F. 2d 303 (C. C. A. 2d 1941).

Building Co. v. Commissioner, T. C. (M) Nos. 103679; C. C. H. Dec. 14306M, in which the debentures which were purchased at a discount in the year 1938 did not mature until 1943. Both courts held that the cancellation of indebtedness was exempt as a gift in spite of the fact that the indebtedness was prepaid.

Third: Even in the field of contract law this prepayment rule applies only where both the debtor and creditor agree and intend that the prepayment is the consideration for the cancellation. This Court, in *Fire Insurance Association, Limited v. Wickham*, 141 U. S. 564, stated at page 579:

> "* * *That prepayment of part of a claim may be a good consideration for the release of the residue is not disputed; but it is subject to the qualification that nothing can be treated as a consideration that is not intended as such by the parties. * * * In *Kilpatrick v. Muirhead*, 16 Penn. St. 117, 126, it was said that 'consideration, like every other part of a contract, must be the result of agreement. The parties must understand and be influenced to the particular action by something of value or convenience and inconvenience recognized by all of them as the moving cause. That which is a mere fortuitous result flowing accidentally from an arrangement, but in no degree prompting the actors to it, is not to be esteemed a legal consideration.' See also 1 *Addison on Contracts*, 15; *Ellis v. Clark*, 110 Mass. 389. Now evidence of what took place at the meeting, if admissible for no other purpose, was competent as bearing upon the question whether the prepayment was mentioned or treated as an inducement or consideration for the release of the residue of the claim."

There is no evidence in the present case that the taxpayer or the bondholders considered this question of prepayment in their negotiations. On the contrary, the evidence is uncontradicted that there was no consideration received by the bondholders other than the amount paid (R. 35). It should be emphasized that neither the Tax Court nor the Court of Appeals made any finding or inti-

mated that prepayment was even considered, discussed or mentioned by either the taxpayer or his creditors in the negotiation, sale or settlement. It must be recalled that the creditors in 1937 extended the maturity date of the bonds until 1942. It is unrealistic to assume that a creditor will extend his bond in one year and within the next year accept 50¢ on the dollar for it if prepayment was the inducing cause of the sale.

Therefore, it cannot be argued that the real inducement or consideration for the cancellation was the prepayment. It was merely a fortuitous result brought about by the sale of the bonds prior to their maturity rather than the reason prompting the taxpayer and the bondholders to consummate the sale.

For the above reasons both the Court of Appeals and the Tax Court were correct in holding that the present case was controlled by the *American Dental Co.* case and that the prepayment did not distinguish the present case nor make the cancellation non-gratuitous.

B. The Decision in The American Dental Co. Case Is Correct and Should Not Be Limited or Overruled.

Petitioner throughout his Brief raises the same arguments made by the Commissioner in the *American Dental Co.* case and attempts to have this Court overrule its former decision that a gratuitous cancellation of indebtedness is exempt from income tax as a gift. He again ignores the common and accepted definition of the term "gift" as approved in the *American Dental Co.* case and attempts to qualify it by the use of such vague and general terms as "arm's length negotiations," "business transactions," and "donative intent."

A gift, as defined by the authorities, is a voluntary transfer of property by one to another without any consideration or compensation therefor, or, as this Court said in the *American Dental Co.* case, the receipt of financial

advantages gratuitously. See *Mertens's Law of Federal Income Taxation*, Vol. 1, Sec. 6.07, pages 241 *et seq.*; *Blair v. Rossiter*, 33 F. 2d 286 (C. C. A. 9, 1929); *Noel v. Parrott*, 15 F. 2d 669, 671 (C. C. A. 4, 1926).

The fact that the cancellation of indebtedness in the present case arose out of a so-called business transaction and that both taxpayer and the bondholders attempted to strike the best possible bargain has nothing to do with whether the cancellation was a gift. The test is whether any valuable consideration was given by the taxpayer for the cancellation. In the *American Dental Co.* case the cancellation was accomplished by means of a business transaction and presumably both the debtor and his creditors tried to strike the best bargain. This did not make the cancellation non-gratuitous and therefore not a gift.

Petitioner argues that the cancellation was not a gift because there was "no donative intent" on the part of the creditors. There is no question but that in the present case the creditors intended to cancel a portion of their claims against the taxpayer and intended that he should receive the benefit of this cancellation without paying anything for it. In the *American Dental Co.* case the evidence shows that the creditors there likewise intended that the debtor should receive the benefit of the cancellation.

Petitioner is confusing the terms "intent" and "motive," and is really saying that if the motive for the cancellation is a business one, the cancellation cannot be gratuitous. As this Court held in the *American Dental Co.* case, the motives are not controlling. The common, accepted definition of the term "gift" shows that the motives of the donor have no bearing on whether a particular transfer is a gift. The significant fact is that in the present case the creditors intended to cancel a portion of their debt without receiving any valuable consideration. What their motives were is of no importance.

This is just what this Court held in *Bogardus v. Commissioner*, 302 U. S. 34 and *Old Colony Trust Co. v. Commissioner*, 279 U. S. 716, with respect to the question whether a bonus to a former employee was a gift or taxable income. The touchstone was held to be the intent of the parties—whether to compensate for services or to make a gift. Their motive—gratitude for past services—was found to be of no significance.

All of these same arguments were presented to this Court in the *American Dental Co.* case. This Court, however, resolved all these issues by holding that when a creditor cancels all or a portion of his claim against his debtor for no consideration, this cancellation is gratuitous and the amount of the forgiven debts is exempt from income tax as a gift within the meaning of Section 22(b)(3) of the Internal Revenue Code.

C. The Present Case Is Entirely Distinguishable from United States v. Kirby Lumber Co., 284 U. S. 1.

The Petitioner argues that the present case is governed by the rule of the *Kirby Lumber Co.* case. Here also the Petitioner is simply again arguing points presented to this Court in the *American Dental Co.* case and completely rejected by it then.

The *Kirby Lumber Co.* case was the first decision determining whether any taxable income resulted from a purchase by a debtor of his own obligations at less than their issue price. Its facts were quite simple. Kirby Lumber Co. had issued bonds in 1923 for a little over $12,000,000 and received in cash the par value thereof. Later in the same year it purchased *in the open market* some of the bonds at a substantial discount and presumably cancelled them. There being no evidence of any shrinkage in assets, this Court, speaking through Mr. Justice Holmes, held that there was a gain in assets previously offset by the obligation of bonds now extinct. Be-

cause of this gain the Court held that it had realized taxable income to that extent.

After the decision in the *Kirby Lumber Co.* case it was quickly realized by the courts and the Treasury Department that every improvement in net assets on the balance sheet of a taxpayer (brought about by a cancellation of his indebtedness) did not result in taxable income. The broad ground upon which the case was placed by Mr. Justice Holmes has been greatly limited and curtailed by the later holdings, although the case has never been directly overruled. The lower courts refused to apply it in many situations even where it clearly appeared that the cancellation did increase the debtor's net assets.

Where the indebtedness was incurred as a part of the purchase price of property, the courts have consistently held that a cancellation of a part of such indebtedness should be treated as a readjustment of the purchase price rather than a taxable gain. See *Hirsch v. Commissioner*, 115 F. 2d 656 (C. C. A. 7th 1940); *Helvering v. A. L. Killian Co.*, 128 F. 2d 433 (C. C. A. 8th 1942); *Commissioner v. Sherman*, 135 F. 2d 68 (C. C. A. 6th 1943).

If the debt is retired by the issuance of stock worth considerably less than the debt, it does not result in taxable income. See *Commissioner v. Capento Securities Corp.*, 140 F. 2d 382 (C. C. A. 1st, 1944).

If the indebtedness is incurred without consideration, its subsequent cancellation does not represent taxable income. See *Commissioner v. Rail Joint Co.*, 61 F. 2d 751 (C. C. A. 2d 1932).

If the cancelled debt is contingent and not absolute, no taxable income results from its cancellation. See *Corporation de Ventas de Salitre y Yoda de Chile v. Commissioner*, 130 F. 2d 141 (C. C. A. 2d 1942); *Terminal Investment Co. v. Commissioner*, 2 T. C. 1004 (1943).

The Treasury Department in its regulation and the lower courts have held that where a stockholder gratuitous-

ly forgives the corporation's debt, it results in a contribution to the capital of the corporation and not a taxable gain. See *Commissioner v. Auto Strop Safety Razor Co.*, 74 F. 2d 226 (C. C. A. 2d 1934); *Carroll-McCreary Co., Inc. v. Commissioner, supra.*

Finally, this Court in the *American Dental Co.* case held that where a creditor gratuitously forgave indebtedness in whole or in part, such forgiveness was wholly exempt under Section 22(b)(3) of the Internal Revenue Code, although there was unquestionably an increase in the taxpayer's net assets.

Thomas M. Tarleau in an article on *Federal Income Tax Considerations Applicable to Cancellation of Indebtedness* published in *Institute on Federal Taxation* (Fifth Annual—New York University—1947), p. 664 correctly summed up the present status of the *Kirby Lumber Co.* case by stating at page 666:

> "The doctrine of *United States v. Kirby Lumber Co.* is still followed in decisions dealing with cancellation of indebtedness, but various exceptions which have been developed have tended to limit such doctrine in practical effect to cases involving the repurchase by a corporation of its bonds at a discount on the open market."

As the Court of Appeals held below, the *Kirby Lumber Co.* case is entirely distinguishable from the present case. In the *Kirby Lumber Co.* case there was not and could not have been any discussion of the question of gratuitous cancellation of indebtedness. There were no negotiations between the Kirby Lumber Co. and its bondholders. Both treated the bonds merely as property to be sold or purchased on the open market. The bondholders could not have had any idea that they were selling to the corporation and thus in effect forgiving a part of their claim. The bondholders did not and could not have intended to cancel any claim against the debtor. As far as they knew such claim remained outstanding in the hands of a new owner.

There was no intent whatever to forgive any indebtedness or otherwise benefit the debtor.

In the present case, on the other hand, each bondholder dealt directly with the taxpayer or his agent. The bondholder, in selling his bond at a discount to the taxpayer, knew that he was surrendering and forgiving the unpaid portion of the debt. He intended to do this and he intended that the debtor should have the advantage of his doing this. Thus, each creditor knowingly and intentionally gave the benefit of the forgiveness to the taxpayer—a true gift, as this Court has held.

It is true that from the economic standpoint of the taxpayer, it makes no difference whether he acquires his obligations in an open market transaction or in a direct transaction with his creditor. In both cases his net assets are increased by the difference between the amount paid and the amount of the debt retired. As previously pointed out, however, this gain in net assets is not the sole test. The distinction between the two types of cases is that normally in an open market transaction there can be no intended cancellation of indebtedness on the part of the creditor since he has no knowledge that his debtor is obtaining a reduction or cancellation of the amount due. He therefore cannot be considered to have made a gift. This is the reasoning of the Tax Court and the Court of Appeals in this case. All cases decided since the *American Dental Co.* case on similar facts have held the same way. See *Bulkley Building Co. v. Commissioner, supra, Shellabarger Grain Products Co. v. Commissioner, supra; A. M. Campau Realty Co. v. United States*, 69 F. Supp. 133 (Ct. Claims, 1947).

The same is true in the employee bonus cases. From the employee's standpoint the result to him is the same whether the bonus is a gift or is compensation for services. However, whether the bonus is taxable to him depends on whether the employer intended to make him a gift or intended to compensate him for past or future services. *Old*

Colony Trust Company v. Commissioner, 279 U. S. 716; *Bogardus v. Commissioner*, 302 U. S. 34.

For the above reasons the Court of Appeals and the Tax Court correctly held the doctrine of the *Kirby Lumber Co.* case inapplicable to the present case, just as this Court held on the same question in the *American Dental Co.* case.

D. Congress Has Indicated No Intent that Gratuitous Cancellations of Indebtedness Be Taxed.

Petitioner argues that since Congress has specifically excluded certain cancellations of indebtedness from taxable gross income (see statutes cited by Pet. Brief, 32-35), all other cases of cancellation of indebtedness should be subject to the income tax. However, as the *American Dental Co.* case held, Congress had already exempted gratuitous cancellations of indebtedness in Section 22(b)(3) of the Internal Revenue Code. If the *American Dental Co.* decision did not represent the intent of Congress in enacting Section 22(b)(3), Congress has had ample time since to point out this Court's error. By failing to make such amendment, Congress has shown its approval of the holding of the *American Dental Co.* case that gratuitous cancellations of indebtedness are gifts excluded from gross income under Section 22(b)(3).

All of the specific statutory exceptions referred to by Petitioner were considered in the *American Dental Co.* case and were cited to illustrate "the uncertainties of the effect of the remission of indebtedness on income tax." (318 U. S. 328.) The enactment by Congress of these specific exemption sections does not in fact indicate any conviction on its part that cancellation or reduction of indebtedness does necessarily result in taxable income even in the circumstances there involved. These sections were motivated by a desire to clarify what was regarded by all as uncertainty in the law rather than to change the existing

rules regarding the taxability of debt cancellations. This circumstance, and the unfortunate confusion resulting from it, is clearly pointed out by this Court in its opinion in *Claridge Apartments Co. v. Commissioner*, 323 U. S. 141. Discussing the uncertainty with respect to the income-producing effect of cancellations of indebtedness, this Court said (p. 146):

> "Some of the obscurity has been created by the very legislation enacted to remove it. This has been true of the successive 'reorganization' provisions, including those for 'non-recognition' and for transfer of 'basis,' which have appeared in the various revenue acts from 1918 (cf. 40 Stat. 1057) forward. Closely related, as these have been, to the problem whether income is realized by the cancellation or reduction of indebtedness in connection with a reorganization, they have tended to obscure if not to blot out that problem altogether in situations covered by their terms.[11]

[11] By assuming the existence of income or other taxable gain, but providing for nonrecognition, the inquiry whether gain or profit actually has accrued is wholly avoided."

Of course, these special statutory provisions do have an important effect where, under other circumstances, reduction or cancellation of indebtedness may result in taxable income. In a situation, for example, where under the *Kirby Lumber Co.* case a purchase and retirement of bonds would be held to result in taxable income, the taxpayer has the option under these sections of postponing the tax to a later time through reduction of the cost basis of his properties.

II.

WITHIN THE MEANING OF THE SIXTEENTH AMENDMENT AND THE INTERNAL REVENUE CODE, THE CANCELLATION OF INDEBTEDNESS HERE DID NOT CREATE INCOME BECAUSE THERE WAS NO GAIN DERIVED FROM LABOR OR CAPITAL.

The Petitioner has asked this Court to reexamine its opinion in the *American Dental Co.* case. He urges this Court to restate the governing principles within the scope of the Sixteenth Amendment and the Internal Revenue Code applicable in determining whether a particular cancellation of indebtedness results in taxable income.

We have set forth in the first section of this brief the reasons why we believe that this Court can and should hold, within the framework of its existing decisions, that the gratuitous cancellation of Respondent's indebtedness, made at arm's length in personal transactions with his creditors, did not result in income taxable to him within the meaning of Section 22(a) and (b) of the Internal Revenue Code. We suggest, however, that if this Court desires to reexamine the fundamental law applicable in these situations, it must reexamine not only the *American Dental Co.* case but its earlier decisions in the *Kirby Lumber Co.* and *American Chicle Co.* cases, in light of its more recent pronouncements in related fields and the basic conceptions of what is income. We are convinced that any such reexamination can only result in the conclusion that the transactions between the taxpayer here and his creditors did not result in any taxable income under Section 22(a).

The most recent reference by this Court to the confusing problem of the income tax treatment of debt cancellation is in its opinion in *Claridge Apartments Co. v. Commissioner*, 323 U. S. 141. We say "confusing" advisedly. That case involved the interpretation of Sections 268, 270 and 276c(3) of the Bankruptcy Act, as amended by the Chandler Act, which related to the income tax treatment of cancellation of indebtedness resulting

from bankruptcy proceedings. This Court introduced its detailed discussion of these sections and their legislative history and effect by reference to the *Kirby Lumber Co.* and *American Dental Co.* cases, saying (p. 146):

> "The question presented by Sec. 276c (3) must be determined in the light of the problem created by §§ 268 and 270. A statement of their history is necessary to a general understanding of that problem. It stems basically from *United States v. Kirby Lumber Co.*, 284 U. S. 1, and subsequent decisions which have applied the principle of that case.[9] By them a corporation may realize income from the cancellation or reduction of indebtedness, depending upon the circumstances in which the transaction occurs. However, the line between income-producing reductions and others is not precise or definite and great uncertainty prevailed concerning it, * * *."

"[9] Cf., e.g., *Helvering v. American Dental Co.*, 318 U. S. 322; *Kraman Dev. Co.*, 3 T. C. 342; *Paul, Debt and Basis Reduction under the Chandler Act* (1940) 15 Tulane L. Rev. 1, 5, and authorities cited in notes 17, 19."

In the seventeen years since this Court's decision in the *Kirby Lumber Co.* case, tax practitioners and commentators have uniformly recognized, and generally bewailed, the uncertainty of the income tax effect of cancellations or reductions of indebtedness.[4] The lower courts have been astute in refinements and distinctions, limiting what was thought to be the rationale of the holding in the *Kirby Lumber Co.* case—that an increase in a debtor's net assets through purchase of his obligations at a discount constitutes an "accession to income" (284 U. S., at 3), includable in taxable income. *Supra*, pp. 13-14.

This confusion was of concern to this Court when it decided the *American Dental Co.* case. After referring to its previous holding that the purchase of a taxpayer's own

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[4] See articles cited Petitioner's Brief, p. 13, footnote 2 and article cited *supra*, p. 14.

bonds at a discount resulted in income, and to the "narrow line" in related situations, this Court recognized that:

> "Possibly because it seems beyond the legislative purposes to exact income taxes for savings on debts, the courts have been astute to avoid taxing every balance sheet improvement brought about through a debt reduction." (318 U. S., at 327.)

Much of this confusion, we respectfully submit, has resulted from a failure to recognize the essential limits on the broad scope of the concept of "income." It might conceivably have been held that increases in the net worth of a taxpayer measured his taxable income, but from the first decisions on the scope of income tax statutes, that all-inclusive concept was rejected. Mere appreciation in the value of a taxpayer's property, although it increases both the value of his assets and his net worth, is not income. That the taxpayer's securities or business property are more valuable at the end of the taxable year than at its commencement is ignored. A taxpayer engaged in business may be wealthier at the conclusion of the period because the selling price of his inventory or stock in trade has increased, but that does not result in income.[5] A farmer does not realize income because a valuable crop grows on his land or because his prize cow has a calf. A desert landholder would not have income when a stream reversed its course and made his desert productive. Nor would the recession of a lake relieving the shore land from the burden of its waters bring income to the owner.

All of these are gains—gains in gross assets and in net assets, but gains alone are not enough. To constitute income, gains must be "derived from capital, from labor, or from both combined." This was the definition of income

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[5] However, in exceptional circumstances a dealer in securities is permitted to value inventories at market value, thereby increasing or reducing his income with market fluctuations. Regulations 111, Sec. 29.22(c)-5,—an exception to the general rule by agreement between the taxpayer and the Commissioner on account of the special nature of that business.

under the Corporation Tax Act of 1909 declared by this Court in *Stratton's Independence, Ltd. v. Howbert*, 231 U. S. 399. In the Sixteenth Amendment Congress was empowered "to lay and collect taxes on incomes, from whatever source *derived*, without apportionment * * *," thereby incorporating the same accepted meaning of the term. See *Eisner v. Macomber*, 252 U. S. 189.

Congress itself clearly recognized the qualification that income includes only gains derived from capital or labor. In Section 22(a) of the Revenue Acts and the Internal Revenue Code it defines "gross income" to include "gains * * * derived from * * * compensation for personal service * * * or from * * * businesses * * * or dealings in property * * *; and income derived from any source whatever." Not all gains are taxed. As the Treasury Department Regulations themselves provide, "income is the gain derived from capital, from labor, or from both combined * * *" (Regulations 111, Section 29.22(a)-1, and prior regulations).

The gain, to be income, must thus be derived from an income-producing transaction or circumstance. Whether a particular gain or profit is income has been decided by an analysis of the circumstances of the gain, and the intent of the parties toward it.

When early confronted with the question whether a Government subsidy to a new railroad was income, this Court analyzed the circumstances of the payment, found that it was not made for services rendered, and that it was not gain "from the use or operation of the railroad," and accordingly held that the payment under those circumstances did not constitute income. *Edwards v. Cuba Railroad Co.*, 268 U. S. 628. On the other hand, when Congress in the Transportation Act of 1920 authorized payments to railroads to restore their income for the period of federal control to a normal operating level, the Court held that such payments were derived by the railroads from their operations and hence constituted income. *Texas & Pacific Rail-*

way Co. v. United States, 286 U. S. 285 and *Continental Tie & Lumber Co. v. United States*, 286 U. S. 290.

After long uncertainty as to the taxable status of so-called bonuses paid to former employees, this Court held in *Bogardus v. Commissioner*, 302 U. S. 34, that where "the disbursements were not made or intended to be made for any services rendered or to be rendered or for any consideration," they were not income. Whether the payment was "derived from" services was held to depend on the intent with which it was made.

Most revealing of all, it is now firmly established that where a taxpayer makes a bargain purchase—secures a gain in his net assets by buying something for less than it is actually worth—such gain is income if it is derived from labor or capital, but is not income if the bargain sale was intended as a separate and distinct transaction unrelated to other circumstances. *Palmer v. Commissioner*, 302 U. S. 63; *Commissioner v. Smith*, 324 U. S. 177.

In the *Palmer* case, United Corporation sold to its stockholders stock it owned in the newly organized American Superpower Co. The price of $25 per share was fixed by the directors as their evaluation of the market value of the stock, but during the three weeks period required for completing the sale it became apparent that the stock was worth far more. This Court held that since there was no intent to distribute any gain to the stockholders, but a bona fide intent to make a straightforward sale of the stock, there was no income. "One does not subject himself to income tax by the mere purchase of property, even if at less than its true value." (302 U. S., at 69.) Such a sale may, of course, be the distribution of a dividend, if intended as such. "But the bare fact that a transaction, on its face a sale, has resulted in a distribution of some of the corporate assets to stockholders, gives rise to no inference that the distribution is a dividend." (302 U. S., at 69-70.)

So with bargain sales made as compensation to employees. In *Commissioner v. Smith*, 324 U. S. 177, an em-

ployer, in consideration of an employee's services, had given him the right to buy at 10¢ per share stock found to have a much higher value when the employee purchased it. This Court declared that "Section 22(a) of the Revenue Act is broad enough to include in taxable income any economic or financial benefit conferred on the employee *as compensation.*" (324 U. S. at 181.) Since the intent was not simply to make a self-contained sale, but rather to confer on the employee something of value derived from his services, this Court held the gain income. As has been frequently held, where there is no intent to compensate, such a bargain purchase is not income.

Thus if a taxpayer achieves a gain by increasing his assets through a bargain purchase, there may be no effect on his income—if the bargain purchase was a self-contained transaction. Such gain may indeed be income, if derived from the taxpayer's services, his ownership of securities or from dealings in property. It may, too, be a gift if the gain was intended to be transferred to the recipient gratuitously and with the intent of benefiting him.

If cancellation of indebtedness results in a gain at all, the treatment of such gain should be on exactly the same footing. If a creditor gratuitously and with intent to benefit his debtor reduces or cancels his indebtedness, the gain may be a gift. If a creditor forgives a debt or accepts less than is owing on account of services rendered to him by the debtor or as a distribution to stockholders or in exchange for property transferred by the debtor, the debtor's gain may be income. But if the creditor accepts less than the face amount of the indebtedness in an arm's-length transaction divorced from other circumstances, any gain the debtor has is not derived from labor or capital and is not income.

Such are the facts in this case. The taxpayer being personally acquainted with the holders of his bonds, but having no other relationship with them, negotiated with them for the purchase of the bonds for less than their face

amount. The creditors, for reasons of their own, saw fit to accept the offered amount. Their decision was made in an arm's-length, self-contained transaction, not to compensate the taxpayer, for any services or otherwise. If the taxpayer had a gain from those transactions, it cannot be said that the gain was derived from his labor or capital. It was therefore not income.

If the taxpayer had purchased from these creditors the bonds of another, at less than their face value, certainly the Petitioner would not claim that he had income. Even if the Petitioner found that such a purchase was for less than the bonds were worth, so that the taxpayer had a gain in assets, Petitioner would not claim that the taxpayer had income. If he had purchased law books at less than their going market value, or had purchased a home at less than it was worth, there would be no income—provided such purchases were self-contained transactions not intended to compensate.

Certainly, the present transaction does not differ—and income does not here result—simply because the gain resulted from a decrease in liabilities with no increase in total assets, rather than from a simple increase in assets through a bargain purchase. It might be urged that where a taxpayer acquires property at a bargain price, tax on the gain is not eliminated but is rather postponed, but that is by no means uniformly true of bargain purchases. The property may never be sold, or it may be sold at a loss rather than a gain. If the property is consumed or if it is a personal property such as a residence, its ultimate disposition may have no effect on taxable income. Refusal of the courts to tax a mere bargain purchase, not derived from labor or capital, is not due to the possibility that in some such cases a similar tax may be later exacted. Indeed, the courts well know that they have no power, absent specific legislation, to postpone the tax on current income or in any guise defer it to another period. If a present gain is income, the courts have no power to

exempt it from tax simply because the same gain may be taxed later.

The obvious truth of the matter is that income is not determined from the existence of a gain alone. That is true whether the gain results from an appreciation in assets, from a bargain purchase, from the elimination of a burden on property or from the cancellation of indebtedness. The gain is income only where in the light of the whole transaction it comes to the taxpayer as a consequence of his labor or dealings in property.

A consistent application of these principles to problems of cancellation of indebtedness would go far toward reducing the confusion now existing in this field. The decision of this Court in the *American Dental Co.* case and the decisions of the lower courts in most of the cases which have followed it, would stand unaffected. Whether such a purchase by a taxpayer of his bonds at a discount as was involved in the *Kirby Lumber Co.* and *American Chicle Co.* cases would result in taxable income would depend upon a fuller review of the circumstances of the case than was provided in this Court's opinions. Instead of a maze of technical and frequently conflicting rules and exceptions, the simple touchstone would be the intent of the parties.

Cancellation of indebtedness would then cease to be an esoteric field remote from the understanding of men of business and an exception to the general principles of income taxation. Whether a debtor received taxable income on the reduction of indebtedness would not be dependent upon unrealistic distinctions but upon the common understanding of financial transactions. As has been said by Mr. Magill, commenting with approval on the holding in the *American Dental Co.* case:

> "There are practical considerations in favor of the majority opinion: the essential unreality of holding that a taxpayer in difficult financial circumstances has realized income when his creditors, in order to keep him in business, forgive all or part of his indebtedness to them." (*Magill, Taxable Income*, p. 255).

Fortunately, the practical unreality of finding income as a result of such a debt forgiveness coincides exactly with the legal impossibility of finding income unless a gain is derived from labor or capital. As we believe we have demonstrated, proper legal analysis of the concept of income concurs in its findings with the practical realities. On both legal and practical grounds, the cancellation of indebtedness arrived at in an arm's-length transaction unaffected by other circumstances is not income.

CONCLUSION.

The court below has properly held that within the existing framework of this Court's decisions reduction of the taxpayer's indebtedness through the purchase of his bonds at less than their face amount did not result in taxable income. Since it was a gratuitous cancellation of indebtedness resulting from personal dealings between the parties, we believe that that holding is correct and should be affirmed.

Likewise, if this Court determines to re-examine its previous decisions on this subject, we submit that proper application to gains from cancellation of indebtedness of principles long and well established in other fields of income taxation, requires the conclusion that a self-contained cancellation of indebtedness not intended as compensation, for services or otherwise, cannot be found to result in taxable income. Upon any such re-examination, therefore, the decision of the court below should be found to be correct and affirmed.

Respectfully submitted,

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